(22)

No. 92-1384

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1993

BARCLAYS BANK PLC,
Petitioner,

VS.

FRANCHISE TAX BOARD,
AN AGENCY OF THE STATE OF CALIFORNIA,
Respondent.

On Writ of Certiorari to the Court of Appeal of the State of California in and for the Third Appellate District

JOINT APPENDIX — VOLUME I

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Petition for Certiorari Filed February 22, 1993
Certiorari Granted November 1, 1993

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The following opinions and orders have been omitted in printing this joint appendix because they appear on the following pages in the Appendix to the printed Petition For A Writ Of Certiorari:

CHRONOLOGICAL LISTING OF RELEVANT DOCKET ENTRIES

November 26, 1984	Complaint for Refund of Taxes filed by Barclays Bank International, Ltd. File No. 325059.
November 26, 1984	Complaint For Refund of Taxes filed by Barclays Bank of California. File No. 325061.
December 24, 1984	Answer to Complaint in File No. 325059.
December 24, 1984	Answer to Complaint in File No. 325061.
February 1, 1985	Stipulation and Order Re Filing of First Amended Answer to Complaint in File No. 325061.
February 1, 1985	First Amended Answer to Complaint in File No. 325061.
February 13, 1985	Order of Trial Court Consolidating the Separate Actions.
April 30, 1986	Request to File An Amicus Curiae Brief by the Government of the United Kingdom.
August 12, 1986	Motion of the United States of America For Leave to Participate as an Amicus Curiae.
August 26, 1986	Memorandum of Points and Authorities of the United Kingdom in Support of Its Motion to File an Amicus Curiae Brief.
September 12, 1986	Order Allowing Filing of an Amicus Curiae Brief by the Government of United Kingdom.
September 15, 1986	Order Allowing Filing of an Amicus Curiae Brief by the United States.
November 10, 1986	Trial Commenced.
December 15, 1986	First Amended Complaint For Refund of Taxes.
February 9, 1987	Plaintiffs' Opening Post Trial Brief.

April 6, 1987	Defendant's Post Trial Brief.
April 30, 1987	Plaintiffs' Post Trial Reply Brief.
June 16, 1987	Trial Court's Intended Decision.
July 17, 1987	Oder Correcting Clerical Errors in Intended Decision.
August 20, 1987	Statement of Decision — Trial Court Judgment in favor of Plaintiffs in both consolidated actions.
October 16, 1987	Notice of Appeal by Defendant Franchise Tax Board in both consolidated actions to the California Court of Appeal in and for the Third Appellate District.
November 16, 1987	Court of Appeal Order to Consolidate Appeals in Barclays Bank International Ltd. v. Franchise Tax Board (Civ. No. C003388) and Barclays Bank of California v. Franchise Tax Board (Civ. No. C003389).
June 10, 1988	Appellant's Opening Brief.
June 17, 1988	Brief of Amicus Curiae Thorn-EMI PLC and EMI Limited in Support of Plaintiffs and Respondents, Barclays Bank International Ltd. and Barclays Bank of California.
August 31, 1988	Brief of Amicus Curiae the Government of Canada in Support of Plaintiffs and Respondents.
August 31, 1988	Brief of Amicus Curiae the Government of the United Kingdom in Support of Plaintiffs and Respondents.
September 9, 1988	Brief of Amicus Curiae the United States in Support of Plaintiffs and Respondents.
September 22, 1988	Respondents' Brief.
December 9, 1988	Appellant's Reply Brief.

October 18, 1990	Respondents' Application to Share Oral Argument with Amicus Curiae the United States.
October 22, 1990	Order granting Respondents' Request for Additional Oral Argument and to Share Time With Amicus Curiae the United States.
November 20, 1990	Oral hearing in Court of Appeal.
November 30, 1990	Decision of Court of Appeal Affirming Judgment of the Trial Court in favor of Respondents.
December 14, 1990	Appellant Franchise Tax Board's Petition for Rehearing to Court of Appeal.
December 24, 1990	Respondents' Answer to Petition for Rehearing.
January 8, 1991	Franchise Tax Board's Petition for Review in California Supreme Court. Dkt No. S019064.
January 29, 1991	Answer to Petition for Review.
February 8, 1991	Reply to Answer to Petition for Review.
February 28, 1991	Order of California Supreme Court Granting Review.
April 1, 1991	Appellant Franchise Tax Board's Opening Brief on the Merits.
April 25, 1991	Brief of Amicus Curiae Multistate Tax Commission in Support of Appellant and Defendant.
May 1, 1991	Respondents' Barclays Bank International and Barclays Bank of California's Answer Brief on the Merits.
May 8, 1991	Brief of Amicus Curiae the Government of the United Kingdom in Support of Plaintiffs and Respondents.

May 14, 1991	Brief of Amici Curiae Banque Nationale de Paris and Bank of the West in Support of Plaintiffs and Respondents Barclays Bank International, Ltd. and Barclays Bank of California.
May 14, 1991	Brief of Amicus Curiae the Government of Canada in Support of Plaintiffs and Respondents.
May 14, 1991	Brief of Amicus Curiae the Committee on State Taxation of the Council of State Chambers of Commerce in Support of Plaintiffs and Respondents.
May 14, 1991	Brief of Amici Curiae the Member States of the European Communities and the Governments of Australia, Austria, Finland, Japan, Norway, Sweden and Switzerland in Support of Plaintiffs and Respondents.
May 15, 1991	Respondents' Brief in Reply to Amicus Curiae Multistate Tax Commission.
May 21, 1991	Brief of Amicus Curiae the United States in Support of Plaintiffs and Respondents.
June 4, 1991	Appellant Franchise Tax Board's Reply Brief on the Merits.
June 7, 1991	Brief of Amicus Curiae the Confederation of British Industry in Support of Plaintiffs and Respondents.
June 7, 1991	Brief of Amici Curiae the Organization for Fair Treatment of International Investment and the Union of Industrial and Employers' Confederations of Europe in Support of Plaintiffs and Respondents.

July 9, 1991	Appellant's Answer to Amicus Curiae Briefs of the United States, Banque de Paris and Bank of the West, Committee on State Taxation of the Council of State Chambers of Commerce, Government of the United Kingdom, Government of Canada, Member States of the European Communities and the Governments of Australia, Austria, Finland, Japan, Norway, Sweden and Switzerland, Confederation of British Industry, Organization for Fair Treatment of International Investment and Union of Industrial and Employers' Confederations of Europe.
March 25, 1992	Order of California Supreme Court Granting the Application of John J. McCarthy, Esq., for Leave to Appear as Counsel Pro Hac Vice and to Present Oral Argument on Behalf of the United States.
April 7, 1992	Oral Argument before the California Supreme Court.
May 11, 1992	Decision of the California Supreme Court Reversing the Judgment of the Court of Appeal and Remanding to the Court of Appeal for Further Proceedings.
August 3, 1992	Petition for a Writ of Certiorari in the United States Supreme Court filed by Barclays Bank PLC. Dkt No. 92-212.
August 27, 1992	Brief of Amici Curiae the Member States of the European Communities and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland in Support of Petitioner Barclays Bank PLC.
August 27, 1992	Brief of Amicus Curiae the Government of the United Kingdom in Support of Petitioner.

August 28, 1992	Brief of Amici Curiae Nestle Holding, Inc. and Genstar Company in Support of Petitioner.
August 28, 1992	Brief of Amici Curiae Organization for International Investment Inc. and Union of Industrial and Employers' Confederations of Europe in Support of Petitioner.
August 31, 1992	Brief of Amicus Curiae the United States in Support of Petitioner.
September 1, 1992	Brief of Respondent Franchise Tax Board in Opposition to Petition For Writ of Certiorari.
September 1, 1992	Brief of Amicus Curiae the Institute of International Bankers in Support of Petitioner.
September 1, 1992	Brief of Amici Curiae National Foreign Trade Council, Inc., National Association of Manufacturers, Chamber of Commerce of the United States of America, United States Council for International Business, Emergency Committee for American Trade, American Petroleum Institute, Chemical Manufacturers Association, Financial Executives Institute, and California Chamber of Commerce in Support of Petitioner.
September 9, 1992	Appellant Franchise Tax Board's Supplemental Brief in California Court of Appeal on Remand.
September 10, 1992	Respondents' Barclays Bank International, Ltd. and Barclays Bank of California's Supplemental Letter Brief in California Court of Appeal on Remand.
October 5, 1992	Order of United States Supreme Court Denying Petition for Certiorari in Dkt No. 92-212.

November 20, 1992	Decision of the California Court of Appeal in and for the Third Appellate District on Remand, Reversing the Judgment of the Trial Court and Directing Entry of Judgment for Franchise Tax Board.
December 4, 1992	Franchise Tax Board's Request for Modification of Opinion on Remand.
December 7, 1992	Petition of Barclays Bank International Ltd. and Barclays Bank of California for Rehearing by Court of Appeal.
December 11, 1992	Franchise Tax Board's Answer to Petition for Rehearing.
December 18, 1992	Order of Court of Appeal Modifying Opinion on Remand and Denying Petition for Rehearing.
December 21, 1992	Barclays Bank International, Ltd. and Barclays Bank of California's Petition for Review in California Supreme Court. Dkt No. S019064.
January 8, 1993	Franchise Tax Board's Answer to Petition for Review.
January 12, 1993	Reply to Answer to Petition for Review.
January 18, 1993	Order of California Supreme Court Denying Review.
February 22, 1993	Petition of Barclays Bank PLC for Writ of Certiorari in United States Supreme Court. Dkt No. 92-1384.
May 17, 1993	Order of United States Supreme Court inviting Solicitor General to file a brief.
October 7, 1993	Brief of United States concluding that the petition should be denied.
November 1, 1993	Order of United States Supreme Court Granting Certiorari.

EXHIBIT 1

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SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SACRAMENTO

BARCLAYS BANK INTERNATIONAL LTD.,
a corporation of the Country of England,

Plaintiff,

vs.

FRANCHISE TAX BOARD,
an agency of the State of California

Defendant.

BARCLAYS BANK OF CALIFORNIA
a California Corporation,

Plaintiff,

vs.

FRANCHISE TAX BOARD,
an agency of the State of California,

Defendant.

No. 32509 & No. 325061 (Consolidated for Purposes of Trial)

ENDORSED: November 3, 1986
JOYCE RUSSELL SMITH, CLERK
By Kathleen L. Burgess, Deputy

SCHEDULE I

JOINT STIPULATION OF FACTS
Trial Date 11-10-86

IT IS HEREBY STIPULATED by and between the parties, through their attorneys of record, that the following facts are agreed and undisputed. This stipulation shall not be construed as a concession by either party of the relevancy or materiality of any of the facts stipulated, and the parties reserve the right to argue the relevance, materiality or weight of any of the facts stipulated.

All documents referred to herein or specifically enumerated are compiled under separate cover, have been reviewed by counsel for the parties and their authenticity and foundational basis admitted. The documents shall be entered into evidence. Nothing contained in this stipulation shall prevent a party from introducing at trial any other or further evidence. With permission of Court, documents described in paragraphs 32, 40, and 41 hereof will be deemed admitted in evidence in entirety without physically presenting the same at trial. Either party may refer to said documents in summary form or as individual exhibits at trial or on appeal as evidence admitted at trial.

Nothing contained herein shall be construed as a waiver by any party of its right to review on appeal any question of law or fact arising in this action in the same manner and to the same extent as if the facts set forth herein had been proven in open court.

The parties will make any computations necessary for inclusion in appropriate findings after the court's decision in this matter.

This stipulation shall only apply to the above-entitled consolidated actions and to any appeals from the judgment of this Court.

FACTS

The following facts are agreed and undisputed:

1. During income year ending September 30, 1977 (hereafter referred to as income year 1977), plaintiff Barclays Bank International Limited ("BBI") was a corporation organized and existing

under the laws of England and was qualified to do, and was doing, business as a banking agency in San Francisco, California.

2. During income year 1977, BBI was engaged in general retail and commercial banking, leasing, and consumer and commercial finance, directly or through subsidiaries, in approximately fifty-five (55) countries and territories.

3. During income year 1977, BBI itself operated through banking agencies or branches in approximately thirty-three (33) nations or territories outside the United Kingdom. BBI operated in the United States through branches or agencies located in the states of Georgia, Massachusetts, Illinois, New York and California.

4. During income year 1977, BBI owned more than fifty percent (50%) of over seventy (70) subsidiaries which operated in approximately thirty-four (34) nations or territories outside the United Kingdom.

5. During income year 1977, BBI owned banking subsidiaries which were organized and operated in the United States, including Barclays Bank of New York ("BBNY") and Barclays Bank of California ("Barcal").

6. During income year 1977, BBI was a wholly-owned subsidiary of Barclays Bank Limited ("BBL"), a United Kingdom clearing bank, organized and existing under the laws of England.

7. During the income year 1977, BBL owned, directly or indirectly, in addition to BBI and its subsidiaries, over one hundred forty (140) subsidiaries, none of which was incorporated under the laws of the United States or any political subdivision or territory thereof, and none of which operated in California or in the United States.

8. During the income year 1977, BBL and all subsidiaries of which it owned more than fifty percent (50%) of the stock, directly or indirectly, including BBI and Barcal, operated in over sixty countries or territories. A list of these subsidiaries showing country of incorporation and equity ownership is attached as trial Exhibit 8. BBL and such subsidiaries will be referred to as the

Barclays Group and individually or collectively as a member or members of the Barclays Group, respectively.

9. During income year 1977, Barcal, a California banking corporation and a wholly-owned subsidiary of BBI, was engaged in the commercial banking business in the State of California where it operated through forty-nine (49) branch banking offices.

10. On January 1, 1985, pursuant to the United Kingdom's Companies Act and the Barclays Bank Act 1984, BBL was merged with BBI under the name Barclays Bank PLC, and a holding company, Barclays PLC, became the parent of Barclays Bank PLC.

11. Defendant Franchise Tax Board ("FTB") is an agency of the State of California. The FTB is vested with the power and duty to administer the Bank and Corporation Franchise Tax Law of the State of California.

12. For the income year 1977, BBI prepared and filed a California Bank and Financial Tax Return and paid a total tax liability to the Franchise Tax Board of $14,447.54.

13. For the income year 1977, Barcal prepared and filed a California Bank and Financial Tax Return and paid a total tax liability to the FTB of $541,276.49.

14. The FTB conducted an audit of the California tax returns of BBI and Barcal for the income year 1977. Upon audit the FTB determined that BBI and Barcal were part of a worldwide unitary business conducted by all members of the Barclays Group.

15. Based upon its determination that BBI and Barcal were a part of a worldwide unitary business conducted by all the members of the Barclays Group, the FTB issued Notices of Additional Tax Proposed to be Assessed (hereafter Notices) as follows: to BBI in the amount of $4,076.02 for a total tax for the income year of 1977 of $18,523.56; to Barcal in the amount of $254,699.45 for a total tax for the income year of 1977 of $795,975.94.

16. The FTB's calculation of BBI's and Barcal's California tax liability was set forth in Schedule 1 of the attachment to the Notices as follows:

BUSINESS INCOME:			
INCOME BEFORE TAXES, SECURITIES GAINS/LOSSES, MINORITY INTERESTS AND EXTRAORDINARY ITEMS ...	pg. 10 Pros.		£270,300,000
SECURITIES GAINS/LOSSES ..	pg. 30 Bbl A/R		(2,400,000)
EXTRAORDINARY ITEMS	pg. 23 Bbl A/R		300,000
TOTAL POUND STERLING			268,200,000
CONVERSION RATE			1.7025
BUSINESS INCOME — IN U.S. DOLLARS			$456,610,500
		BBI	Barcal
APPORTION TO CALIFORNIA		$149,083	$6,406,245
TAX RATE		.12425	.12425
TAX....................................		$ 18,524	$ 795,976
TAX PREVIOUSLY ASSESSED		$ 14,448	$ 541,276
ADDITIONAL TAX		$ 4,076	$ 254,700

17. The reference to "page 10 PROS" is a reference to page 10 of the Preliminary Prospectus dated March 31, 1981 $125,000,000 Barclays North American Capital Corporation % Guaranteed Capital Notes due 2006. The references to pages 30 and 23 respectively were references to the BBL Reports and Accounts for 1977. The reference to "TAX PREVIOUSLY ASSESSED" means the tax paid by BBI and Barcal on filing, net of certain refunds.

18. BBI and Barcal filed protests of the proposed assessments in 1982, which protests were timely. BBI had originally filed its tax returns for the income year 1977 on the basis that it was part of a unitary business composed of itself and its subsidiaries. BBI protested the tax on the basis, *inter alia*, that the correct method upon which to compute its tax liability was separate entity/arm's length accounting.

19. Barcal timely filed a protest of the proposed assessment. It had originally filed its tax returns for the income year 1977 on a

separate entity/arm's length accounting basis, and protested the additional assessment on the basis, *inter alia*, that the correct method upon which to compute its tax was separate entity/arm's length accounting.

20. On May 21, 1984, BBI paid the additional proposed tax of $4,076.02 and BBI's administrative protest was converted by operation of law into a claim for refund of taxes. It is upon this claim that the instant litigation is based.

21. On October 31, 1983, Barcal paid additional proposed tax of $250,000.00 and Barcal's protest was converted by operation of law into a claim for refund of taxes. It is upon this claim that the instant litigation is based.

22. After the issuance by the FTB of the Notices and the filing by BBI and Barcal of the protest, the FTB adjusted the audit schedules as follows:

BUSINESS INCOME PER AUDIT	£268,200,000
LESS: INCOME OF ASSOCIATED COMPANIES	(39,700,000)
ADD: DIVIDENDS FROM ASSOCIATED COMPANIES.............................	5,105,000
ANZ GROUP DIVIDEND	735,000
ADD: ACCOUNTING METHOD CHANGE (AMORTIZATION — FROM AGREEMENT PRIOR YRS)	1,429,000
ADD: EXTRAORDINARY INCOME, AMOUNT THAT HAD BEEN EXCLUDED (ATTRIBUTABLE TO MINORITY SHAREHOLDERS)	100,000
REVISED BUSINESS INCOME — POUND STERLING..................................	£235,869,000
CONVERSION RATE	1.7025
REVISED BUSINESS INCOME — U.S. $	$401,566,973
REVISED APPORTIONMENT % — BBI	.0003232
INCOME APPORTIONED TO CALIFORNIA	129,786
TAX RATE....................................	12.425%

TOTAL REVISED TAX		16,126
PREVIOUSLY ASSESSED		14,448
ADDITIONAL TAX — REVISED BBI	$	1,678
REVISED APPORTIONMENT % — BARCAL		.0139032
INCOME APPORTIONMENT TO CALIFORNIA		5,583,066
TAX RATE		12.425%
TOTAL REVISED TAX		693,696
PREVIOUSLY ASSESSED		541,276
ADDITIONAL TAX — REVISED BARCAL	$	152,420

23. Board issued Notices of Action on Taxpayer's Protest to BBI and Barcal on February 15, 1985, for the amounts set forth in paragraph 22.

24. The payment of $250,000.00 made by Barcal on October 31, 1983 was credited by the Board against Barcal's additional tax as revised of $152,419.01. The remaining amount was credited to the interest owing on such liability and on April 19, 1985 an additional payment of $25,670.82 with respect to the interest owing on the $152,419.01 tax was made and credited to Barcal's account. The total amount of refund being sought by Barcal in this case is tax in the amount of $152,419.01 and interest of $123,251.81.

25. Payment of $4,076.02 made to BBI on May 21, 1984 was credited against the revised tax of $1,678.46 and interest on such amounts of $1,505.06. The remaining amount of $892.50 was subsequently refunded to BBI with interest as provided by law. These additional payments of $1,678.46 of tax and $1,505.06 of interest are the amounts for which BBI is seeking a refund in this action.

26. The FTB, through its attorney Marvin J. Halpern ("Halpern"), and BBI and Barcal, through their attorney Joanne M. Garvey ("Garvey"), have corresponded regarding, *inter alia,* plaintiffs' respective Section 25137 petitions for the income years ending September 30, 1977, 1978 and 1979 and December 1, 1979. In addition members of the FTB or the FTB staff have drafted certain documents concerning Section 25137 petitions. These documents include:

26a. Letter from Garvey to Halpern dated May 18, 1984.

26b. Letter from H. Barry Berlin to California Franchise Tax Board, dated May 22, 1984.

26c. Photocopies of checks numbers 45007-45009 of BBI, dated May 21, 1984 drawn on Barclays Bank International Limited account payable to the Franchise Tax Board.

26d. Letter from Halpern to Garvey dated June 22, 1984.

26e. Letter from Garvey to Halpern dated June 28, 1984.

26f. Letter from Halpern to Garvey dated July 24, 1984.

26g. Letter from Garvey to Halpern dated September 11, 1984.

26h. Letter (via Telex) from Garvey to Halpern dated November 9, 1984.

26i. Letter from Halpern to Garvey dated January 28, 1985.

26j. FTB's Notice of Action on Taxpayer's Protest to Barcal, dated February 15, 1985.

26k. FTB's Notice of Action on Taxpayer's Protest to BBI, dated February 15, 1985.

26l. Letter from Garvey to Halpern, dated June 28, 1985.

26m. Letter from Halpern to Garvey dated January 8, 1986.

26n. Exhibit No. 3 to Marvin Halpern's deposition taken January 16-17, 1986, entitled "Statement of the Franchise Tax Board Pertaining to Section 25137 Petitions."

26o. Memorandum from Martin Huff to Walter Harvey, concerning "Petitions for Relief under Section 25137 Bank and Corporation Tax Law," dated June 23, 1977.

26p. Memorandum from Benjamin F. Miller to Martin Huff, Executive Officer, concerning "Meeting with Dennis Amundsun, Director Department for Eco-

nomic and Business Development," dated March 21, 1978.

26q. Memorandum from Marvin J. Halpern to Glenn L. Rigby dated July 25, 1984.

26r. Letter from R.E. Gilbert to the California Franchise Tax Board, dated October 31, 1983.

27. For purposes of this litigation only, BBI and Barcal agree that for income year 1977 they were members of a worldwide unitary business within the meaning of Revenue and Taxation Code Section 25101, *et seq.*, composed of the members of the Barclays Group.

28. On September 23, 1983, United States Secretary of Treasury, Donald T. Regan, announced the establishment of the Worldwide Unitary Taxation Working Group ("Working Group").

29. The Final Report of the Worldwide Unitary Taxation Working Group, Chairman's Report and Supplemental Views, August 1984, was transmitted to the President of the United States on August 31, 1984.

30. Among those testifying before, or submitting reports to, the Working Group or the Task Force of the Working Group were:

30a. Statement of the United Kingdom before the United States Treasury Working Group on Worldwide Unitary Taxation.

30b. Presentation by Mr. Barry Pollard, Inland Revenue, on United Kingdom Experience of Operating the Arms Length Principle With Special Reference to Transfer Pricing Enquiries.

30c. Statement of Canada before the United States Worldwide Unitary Taxation Working Group.

30d. Submission of the Australian Government to the U.S. Task Force on Unitary Taxation, dated January 4, 1984.

31. Trial Exhibit 31 to this stipulation is a true and accurate summary chart of the country of incorporation and the financial operating profit in pounds sterling of the members of the Barclays Group as set forth in the business records of the companies comprising the Group, prepared in the ordinary course of business and used, among other things, for the preparation of the Reports and Accounts of the Barclays Group.

32. Foreign governments, on their own behalf or as the representatives of official governmental bodies such as the European Economic Community (EEC), have sent communications (collectively trial Exhibit 32) to the United States government and to the several states of the United States, including California, expressing objections to use by the states, including California, of the worldwide combined reporting unitary method of state taxation. Some of these are:

32a. Letter from Hon. Nigel Lawson, Chancellor of the Exchequer for the United Kingdom to the United States Secretary of the Treasury, Hon. Donald T. Regan, dated July 12, 1983.

32b. Demarche from Italy, as President of the EEC, on behalf of the Nine European Economic Community Governments to the Department of State, Washington, D.C., dated March 19, 1980.

32c. Demarche No. 51 from the United Kingdom Embassy to the Department of State, Washington, D.C., dated March 25, 1980.

32d. Demarche No. 211 from the United Kingdom, as President of the EEC, on behalf of the Ten European Economic Community Governments to the Department of State, Washington, D.C., dated October 30, 1981.

32e. Demarche No. 692 from the Embassy of Canada to the Department of State, Washington, D.C., dated December 22, 1981.

32f. Demarche No. 83 from the United Kingdom Embassy to the Department of State, Washington, D.C., dated May 18, 1982.

32g. Demarche No. 283 from the Embassy of Canada to the Department of State, Washington, D.C., dated June 14, 1982.

32h. Demarche from the Government of Belgium as President of the EEC, on behalf of the ten European Economic Community Governments to the Department of State, Washington, D.C., dated June 29, 1982.

32i Demarche from Greece, as President of the EEC, on behalf of the ten European Economic Community Governments to the Department of State, Washington, D.C., dated August 1, 1983.

32j. Demarche No. 481 from the Embassy of Canada to the Department of State, Washington, D.C., dated September 28, 1983.

32k. Demarche No. 383/83 from the Embassy of Australia to the Department of State, Washington, D.C., dated November 7, 1983.

32l. Demarche No. 461.20-LJ/hu from the Embassy of Switzerland to the Department of State, Washington, D.C., dated November 15, 1983.

32m. Demarche from the Federal Republic of Germany to the Department of State, Washington, D.C., dated November 28, 1983.

32n. Demarche No. EA-14533 from the Embassy of the Kingdom of the Netherlands to the Department of State, Washington, D.C., dated December 21, 1983.

32o. Demarche from the Embassy of Belgium on behalf of the ten European Economic Community Governments, the European Commission and the Embassies of Australia, Canada, Japan and Switzerland to the

Department of State, Washington, D.C., dated January 25, 1984.

32p. Demarche from the Embassy of Belgium to the Department of State, Washington, D.C., dated January 25, 1984.

32q. Demarche No. 634 from the Embassy of Canada to the Department of State, Washington, D.C., dated February 27, 1984.

32r. Aide-memoire from the Government of Japan to the United States Government dated June 6, 1984.

32s. Official correspondence from the Hon. Marc Lalonde, Minister of Finance for Canada to the United States Secretary of the Treasury, Hon. Donald T. Regan, dated August 11, 1983.

32t. Letter from W. Wachtmeister, Swedish Ambassador to the United States, and the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, Norway, the Kingdom of the Netherlands, Sweden, Switzerland, the United Kingdom and the Commission of the European Communities to the Hon. Robert Bangter, Governor of the State of Utah, dated February 15, 1985.

32u. Letter from J.L. Beaven, United Kingdom Consul-General to the United States, to the Hon. Willie L. Brown, Jr., Speaker of the California Assembly, dated June 18, 1984.

32v. Letter from W. Wachtmeister, Swedish Ambassador to the United States, and the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, Norway, Sweden, Switzerland, the United Kingdom and the Commission of the European Communities to the Honorable

Richard D. Lamm, Governor of the State of Colorado, dated January 25, 1985.

32w. Letter from W. Wachtmeister, Swedish Ambassador to the United States, and the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, Norway, the Kingdom of the Netherlands, Sweden, Switzerland, the United Kingdom and the Commission of the European Communities to the Hon. George A. Sinner, Governor of the State of North Dakota, dated March 18, 1985.

32x. Letter from Jacques S. Roy of the Embassy of Canada to the Hon. Robert Graham, Governor of the State of Florida, dated May 30, 1984.

32y. Letter from J. Raoul Schoumaker of the Embassy of Belgium and the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, The Kingdom of the Netherlands, Sweden, Switzerland, the United Kingdom and the Commission of the European Communities to the Hon. Robert Graham, Governor of the State of Florida, dated November 28, 1984.

32z. Letter from H.G. Walsh, Counsellor (Economic) British Embassy Washington, D.C. to the Honorable Edmund G. Brown, Governor of the State of California, dated October 30, 1981.

32aa. Letter from Christopher E. F. Davis, Consul Canadian Consulate, San Francisco, California to Gerald Goldberg, Executive Officer Franchise Tax Board of California, dated January 26, 1984.

32bb. Letter from J. L. Beaven, Her Majesty's Consul-General to the Honorable George Deukmejian, Governor of California, dated June 21, 1983.

32cc. Letter from the United Kingdom Chancellor of the Exchequer to the Secretary of the United States Treasury dated June 20, 1985.

32dd. Undated Memorandum from the Netherlands Government to the Governor of California.

32ee. Letter from the Hon. Pierre Trudeau to Hon. Ronald Reagan, President of the United States, dated September 24, 1983.

33. The following documents pertaining to treaties of Friendship, Commerce, and Navigation were provided to Benjamin F. Miller, Counsel for Multistate Tax Affairs for the FTB, by the Department of State:

33a. The first page and pages 15 and 16 of a Memorandum to the Embassy at Chungking for Use in Negotiating Treaty of Friendship, Commerce and Navigation. These pages, constituting the only pages received of the above-mentioned document by the FTB were enclosures to the letter dated August 22, 1980 referred to in paragraph 33(c).

33b. The first page and pages 16 through 19 of a Memorandum to the American Embassy at Rio de Janeiro for Use in Negotiating Treaty of Friendship, Commerce and Navigation Between the United States and Brazil. These pages, constituting the only pages received of the above-mentioned document by the FTB, were enclosures to the letter dated August 22, 1980 referred to in paragraph 33(c).

33c. The cover page and pages ii, 19, 20, 21, 202 and 203 of a preliminary draft of a study entitled *Standard Draft Treaty of Friendship, Commerce and Navigation* prepared under contract to the Department of State by Charles H. Sullivan. These pages, constituting the only pages received of the above-mentioned document by the FTB, were enclosures to a letter dated August 22, 1980 and

signed by Stuart E. Benson, Acting Assistant Legal Advisor, Office of the Legal Advisor, Department of State, addressed to D. R. Milton, Vice President Tax, Shell Oil Company, Houston, Texas carbon copy to Benjamin F. Miller, Franchise Tax Board, State of California.

33d. Pages 13a through 15 of Annotated Draft FCN for Portugal prepared by Herman Walker. These pages, constituting the only pages received of the above-mentioned document by the FTB, were enclosures to the letter dated August 22, 1980 referred to in paragraph 33(c).

33e. HICOG Bonn Despatch No. 2255 of February 17, 1954, pages 1 through 5 inclusive, with two page attachment No. 1868. These documents were enclosures to the letter dated August 22, 1980 referred to in paragraph 33(c).

33f. A three page Airgram of the Department of the State dated July 3, 1983 concerning FCN Treaty with the Netherlands, and replying to Embassy dispatch 1472. This document was an enclosure to a letter dated August 28, 1980, from Stuart E. Bensen, Acting Assistant, Legal Advisor, Office of the Legal Advisor, addressed to D.R. Milton, Vice President of Tax, Shell Oil Company, Houston, Texas, carbon copy to Benjamin F. Miller, Franchise Tax Board.

33g. Letter dated February 11, 1981 from Theodore W. Kassinger, Attorney Advisor, Office of Assistant Legal Advisor for Economic and Business Affairs, Department of State.

34. On July 9-10, 1985, the Parliament of the United Kingdom debated and unanimously passed legislation in Clause 27 of the Finance Act of 1985. The proceedings of Parliament are truly and accurately reported in the House of Commons Official Report,

Parliamentary Debates (Hansard), Wednesday 10 July 1985, Volume 82, No. 152.

35. The United Kingdom's Finance Act of 1985.

36. There have been discussions and debates in, and documents presented to, the United States Congress concerning the use by the states of worldwide combined reporting, some of which are reported as follows:

36a. Statement of Senators Wilson and Mathias and Statement by the President of the United States in support of the Unitary Tax Repealer Act. 131 Cong. Rec. 17975-17978 (1985).

36b. Executive Session and Statement of Senator Hiyakawa regarding consideration of the United Kingdom-United States treaties. 125 Cong. Rec. 17427-17435, 17796 (1979).

36c. Executive session regarding consideration of tax convention with the United Kingdom. 124 Cong. Rec. 18402-18430 (1978).

36d. Executive session continued regarding consideration of tax convention with the United Kingdom. 124 Cong. Rec. 18651-18670, 18709-18712 and 19076-19078 (1978).

36e. Introduction of H.R. 3980 by Hon. John J. Duncan as reported in the Congressional Record of December 19, 1985 on pages E5754 and 5755 (extension of remarks)

37. Various committees of the United States Congress have held hearings on the issues of state taxation, including the use by the states of worldwide combined reporting, which committees' proceedings, some of which have been transcribed or which committees have issued reports, as follows:

37a. Committee on Ways and Means, 95th Congress, 1st Sess., Recommendations of the Task Force on Foreign Source Income (Comm. Print 1977).

37b. Senate Committee on Foreign Relations, Third Protocol to the 1975 Income Tax Convention With the United Kingdom of Great Britain, and Northern Ireland, as Amended, S. Doc. No. 5, 96th Congress, 1st Sess. (1979).

37c. Tax Treaties With the United Kingdom, the Republic of Korea, and the Republic of the Philippines, 1977: Hearings Before the Senate Committee on Foreign Relations, 96th Congress, 1st Sess. (1977).

37d. State Taxation of Foreign Source Income, 1980: Hearings on H.R. 5076 Before the House of Representatives Committee on Ways and Means, 86th Congress, 2d Sess. (1980).

37e. State Taxation of Interstate Commerce and Worldwide Corporate Income, 1980: Hearings on S. 983 and S. 1688 Before the Subcomm. on Taxation and Debt Management Generally of the Senate Comm. on Finance, 96th Congress, 2d. Sess. (1980).

37f. Unitary Taxation, 1984: Hearings before the Subcomm. on International Economic Policy of the Senate Foreign Relations Comm., 98th Cong., 2d Sess. (1984).

37g. Interstate Taxation, S. 2173: Hearings before the Senate Committee on the Judiciary, 95th Cong., 1st and 2nd Sess. (1977-1978).

38. Various proposed Legislative bills have been introduced in the United States Congress that would, among other things, affect the states' use of worldwide combined reporting. Some of these bills are:

38a. H.R. 11798 (Willis) (1965)

38b. S. 916 (Ribicoff) (1969)

38c. S. 317 (Ribicoff) (1971)

38d. S. 4080 (Mathias) (1972)

38e. S. 2173 (Mathias) (1977)

38f. S. 1688 (Mathias) (1979)

38g. H.R. 5076 (Conable) (1979)

38h. H.R. 5903 (Satterfield) (1979)

38i. H.R. 8277 (Broyhill) (1980)

38j. H.R. 1983 (Conable) (1981)

38k. H.R. 6402 (Rodino) (1982)

38l. H.R. 2918 (Conable) (1983)

38m. H.R. 3243 (Frenzel) (1983)

38n. S. 1225 (Mathias) (1983)

38o. H.R. 4940 (Wyden) (1984)

38p. H.R. 6146 (Mica) (1984)

38q. S. 3061 (Hawkins) (1984)

38r. H.R. 3980 (Duncan) (1985)

38s. S. 1113 (Mathias) (1985)

38t. S. 1974 (Wilson) (1985)

39. The FTB and various committees of the California State Legislature have held hearings on California's use of world-wide combined reporting, some of which have been transcribed, as follows:

39a. Hearing of State of California Franchise Tax Board, Monday, August 22, 1977, 9:30 a.m.

39b. Hearing of State of California Franchise Tax Board, Tuesday, July 12, 1977, 10:00 a.m.

39c. Hearing, Assembly Revenue and Taxation Committee, Willie L. Brown, Jr., Chairman, Los Angeles, November 1979.

39d. Interim Hearing, Assembly Committee on Revenue and Taxation, San Diego, November 7, 1980.

40. As of January 30, 1986, the United States was a party to income tax treaties for the avoidance of double taxation with thirty-three (33) countries, as follows:

40a. Convention between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation, signed August 6, 1982, entered into force October 31, 1983.

40b. Convention between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation, signed October 25, 1956, entered into force October 10, 1957.

40c. Convention between the Government of the United States of America and the Government of Belgium for the Avoidance of Double Taxation, signed July 9, 1970, entered into force October 13, 1972.

40d. Convention between the Government of the United States of America and the Government of Canada for the Avoidance of Double Taxation, signed September 26, 1980, amended by protocols signed June 14, 1983 and March 23, 1984, entered into force August 16, 1984.

40e. Convention between the Government of the United States of America and the Government of Denmark for the Avoidance of Double Taxation, signed May 6, 1948, entered into force December 1, 1948.

40f. Convention between the Government of the United States of America and the Government of Egypt for the Avoidance of Double Taxation, signed August 24, 1980, entered into force December 31, 1981.

40g. Convention between the Government of the United States of America and the Government of Finland for the Avoidance of Double Taxation, signed March 6, 1970, entered into force February 28, 1971.

40h. Convention between the Government of the United States of America and the Government of France for the Avoidance of Double Taxation, signed June 28, 1967, entered into force August 11, 1968, modified by protocol signed October 12, 1970, entered into force February 21, 1971, modified by protocol dated November 24, 1978, entered into force October 27, 1979.

40i. Convention between the Government of the United States of America and the Government of the Federal Republic of Germany for the Avoidance of Double Taxation, signed July 22, 1954, entered into force December 20, 1954, modified by protocol signed September 17, 1965, entered into force December 27, 1965.

40j. Convention between the Government of the United States of America and the Government of Greece for the Avoidance of Double Taxation, signed April 20, 1953, amended by protocol dated April 20, 1953, entered into force December 30, 1953.

40k. Convention between the Government of the United States of America and the Government of Hungary for the Avoidance of Double Taxation, signed February 12, 1979, entered into force September 18, 1979.

40l. Convention between the Government of the United States of America and the Government of Iceland for the Avoidance of Double Taxation, signed May 7, 1975, entered into force December 26, 1975.

40m. Convention between the Government of the United States of America and the Government of Ireland for the Avoidance of Double Taxation, signed September 13, 1949, entered into force December 20, 1951.

40n. Convention between the Government of the United States of America and the Government of Italy for the Avoidance of Double Taxation, signed March 30, 1955, entered into force October 26, 1956.

40o. Convention between the Government of the United States of America and the Government of Jamaica for the Avoidance of Double Taxation, signed May 21, 1980, amended by protocol signed May 21, 1980, entered into force December 29, 1981.

40p. Convention between the Government of the United States of America and the Government of Japan for the Avoidance of Double Taxation, signed March 8, 1971, entered into force July 9, 1972.

40q. Convention between the Government of the United States of America and the Government of Korea for the Avoidance of Double Taxation, signed June 4, 1976, entered into force October 29, 1979.

40r. Convention between the Government of the United States of America and the Government of Luxembourg for the Avoidance of Double Taxation, signed December 18, 1962, entered into force December 22, 1984.

40s. Convention between the Government of the United States of America and the Government of Malta for the Avoidance of Double Taxation, signed March 21, 1980, entered into force May 18, 1982.

40t. Convention between the Government of the United States of America and the Government of Morocco for the Avoidance of Double Taxation, signed August 1, 1977, entered into force December 30, 1981.

40u. Convention between the Government of the United States of America and the Government of the Kingdom of the Netherlands for the Avoidance of Double Taxation, signed April 29, 1948, entered into

force December 1, 1948, as modified by supplementary convention signed December 30, 1965, entered into force July 8, 1966.

40v. Convention between the Government of the United States of America and the Government of New Zealand for the Avoidance of Double Taxation, signed July 23, 1982, entered into force November 2, 1983.

40w. Convention between the Government of the United States of America and the Government of Norway for the Avoidance of Double Taxation, signed December 3, 1971, entered into force November 29, 1972, modified by protocol signed September 19, 1980, entered into force December 15, 1981.

40x. Convention between the Government of the United States of America and the Government of Pakistan for the Avoidance of Double Taxation, signed July 1, 1957, entered into force May 21, 1959.

40y. Convention between the Government of the United States of America and the Government of the Philippines for the Avoidance of Double Taxation, signed October 1, 1976, entered into force October 16, 1982.

40z. Convention between the Government of the United States of America and the Government of Poland for the Avoidance of Double Taxation, signed October 8, 1974, entered into force June 22, 1976.

40aa. Convention between the Government of the United States of America and the Government of Romania for the Avoidance of Double Taxation, signed December 4, 1973, entered into force February 26, 1976.

40bb. Convention between the Government of the United States of America and the Government of Sweden for the Avoidance of Double Taxation, signed March 23,

1939, entered into force November 14, 1939, modified by supplementary convention signed October 22, 1963, entered into force September 11, 1964.

40cc. Convention between the Government of the United States of America and the Government of Switzerland for the Avoidance of Double Taxation, signed May 24, 1951, entered into force September 22, 1951.

40dd. Convention between the Government of the United States of America and the Government of Trinidad and Tobago for the Avoidance of Double Taxation, signed January 9, 1970, entered into force December 30, 1970.

40ee. Convention between the Government of the United States of America and the Government of the Republic of South Africa for the Avoidance of Double Taxation, signed December 13, 1946, entered into force July 15, 1952, modified by supplementary protocol signed July 14, 1950, entered into force July 15, 1952.

40ff. Convention between the Government of the United States of America and the Government of the Union of Soviet Socialist Republics for the Avoidance of Double Taxation, signed June 20, 1973, entered into force January 29, 1976.

40gg. Convention between the Government of the United States of America and the Government of the Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, signed December 31, 1975, entered into force April 25, 1980, modified by notes exchanged on April 13, 1976, amended by first protocol signed August 26, 1976, second protocol

signed March 31, 1977, and third protocol signed March 15, 1979, all entered into force July 25, 1980.

41. As of December 16, 1985, the United Kingdom was a party to seventy-eight (78) treaties for the avoidance of double taxation on income, as follows:

41a. Double Taxation Relief (Antigua) Order 1947 (S.R. & O 1947 No. 2865), amended (S.I. 1968 No. 1096).

41b. Double Taxation Relief (Australia) Order 1967 (S.I. 1968 No. 305), protocol (S.I. 1980 No. 707).

41c. Double Taxation Relief (Austria) Order 1970 (S.I. 1947 No. 1947), protocol 1980 (S.I. 1979 No. 117).

41d. Double Taxation Relief (Bangladesh) Order 1979 (S.I. 1980 No. 1947), protocol 1980 (S.I. 1979 No. 708).

41e. Double Taxation Relief (Barbados) Order 1970 (S.I. 1970 No. 952), protocol 1973 (S.I. 1973 No. 2096).

41f. Double Taxation Relief (Belgium) Order 1967 (S.I. 1970 No. 636).

41g. Double Taxation Relief (Belize) Order 1947 (S.R. & O 1947 No. 2866), amended 1962 (S.I. 1968 No. 573), amended 1973 (S.I. 1973 No. 2097).

41h. Double Taxation Relief (Botswana) Order 1977 (S.I. 1978 No. 183).

41i. Double Taxation Relief (Brunei) Order 1950 (S.I. 1950 No. 1977), amended 1968 (S.I. 1968 No. 306), amended 1973 (S.I. 1973 No. 2098).

41j. Double Taxation Relief (Burma) Order 1950, protocol 1951 (S.I. 1952 No. 751).

41k. Double Taxation Relief (Canada) Order 1978 (S.I. 1980 No. 709), protocol 1980 (S.I. 1980 No. 1528), protocol (S.I. 1985 No. 1996).

41l. Double Taxation Relief (China) Order 1984 (S.I. 1984 No. 1826).

41m. Double Taxation Relief (Cyprus) Order 1974 (S.I. 1975 No. 425), protocol 1980 (S.I. 1980 No. 1529).

41n. Double Taxation Relief (Denmark) Order 1980 (S.I. 1980 No. 1960).

41o. Double Taxation Relief (Dominican Republic) Order 1949 (S.I. 1949 No. 359), amended 1968 (S.I. 1968 No. 1098).

41p. Double Taxation Relief (Egypt) Order 1980 (S.I. 1980 No. 1091).

41q. Double Taxation Relief (Falkland Islands) Order 1984 (S.I. 1984 No. 363).

41r. Double Taxation Relief (Faroe Islands) Order 1950 (S.I. 1950 No. 1195), extended 1960 (S.I. 1961 No. 579), protocol 1969 (S.I. 1969 No. 1068), extended 1970 (S.I. 1971 No. 717), protocol 1973 (S.I. 1973 No. 1326), extended 1975 (S.I. 1975 No. 2190).

41s. Double Taxation Relief (Fiji) Order 1975 (S.I. 1976 No. 1342).

41t. Double Taxation Relief (Finland) Order 1969 (S.I. 1970 No. 153), protocol 1979 (S.I. 1980 No. 710), protocol 1984 (S.I. 1985 No. 1997).

41u. Double Taxation Relief (France) Order 1968 (S.I. 1968 No. 1869), protocol 1973 (S.I. 1973 No. 1328).

41v. Double Taxation Relief (Gambia) Order 1980 (S.I. 1980 No. 1963).

41w. Double Taxation Relief (Federal Republic of Germany) Order 1964 (S.I. 1967 No. 25), protocol 1970 (S.I. 1971 No. 874).

41x. Double Taxation Relief (Ghana) Order 1977 (S.I. 1978 No. 785).

41y. Double Taxation Relief (Greece) Order 1953 (S.I. 1954 No. 142).

41z. Double Taxation Relief (Grenada) Order 1949 (S.I. 1949 No. 361), amended 1968 (S.I. 1968 No. 1867).

41aa. Double Taxation Relief (Guernsey) Order 1952 (S.I. 1952 No. 1215).

41bb. Double Taxation Relief (Hungary) Order 1977 (S.I. 1978 No. 1056).

41cc. Double Taxation Relief (India) Order 1981 (S.I. 1981 No. 1120).

41dd. Double Taxation Relief (Indonesia) Order 1975 (S.I. 1975 No. 2191).

41ee. Double Taxation Relief (Republic of Ireland) Order 1976 (S.I. 1976 No. 2151), protocol 1976 (S.I. 1976 No. 2152).

41ff. Double Taxation Relief (Isle of Man) Order 1955 (S.I. 1955 No. 1205).

41gg. Double Taxation Relief (Israel) Order 1962 (S.I. 1962 No. 616), protocol 1970 (S.I. 1971 No. 391).

41hh. Double Taxation Relief (Italy) Order 1960, exchange of notes 1960 (S.I. 1962 No. 2787), protocol 1969 (S.I. 1973 No. 1763).

41ii. Double Taxation Relief (Jamaica) Order 1973 (S.I. 1973 No. 1329).

41jj. Double Taxation Relief (Japan) Order 1969, exchange of notes 1969 (S.I. 1970 No. 1948), protocol 1980 (S.I. 1980 No. 1530).

41kk. Double Taxation Relief (Jersey) Order 1952 (S.I. 1952 No. 1216).

41ll. Double Taxation Relief (Kenya) Order 1973, protocol 1976, exchange of notes 1977 (S.I. 1977 No. 1299).

41mm. Double Taxation Relief (Kiribati and Tuvalu) Order 1950 (S.I. 1950 No. 750), amended 1968 (S.I. No. 309), amended 1974 (S.I. 1974 No. 1271).

41nn. Double Taxation Relief (Korea) Order 1977, protocol 1977 (S.I. 1978 No. 786).

41oo. Double Taxation Relief (Lesotho) Order 1949 (S.I. No. 2197), amended 1968 (S.I. 1968 No. 1868).

41pp. Double Taxation Relief (Luxembourg) Order 1967 (S.I. 1968 No. 1100), protocol 1978 (S.I. 1980 No. 567), protocol 1983 (S.I. 1984 No. 364).

41qq. Double Taxation Relief (Malawi) Order 1955 (S.I. 1956 No. 619), amended 1964 (S.I. 1964 No. 1401), amended 1968 (S.I. 1968 No. 1101), amended 1978 (S.I. 1978 No. 302).

41rr. Double Taxation Relief (Malaysia) Order 1973, protocol 1973 (S.I. 1973 No. 1330).

41ss. Double Taxation Relief (Malta) Order 1962 (S.I. 1962 No. 639), amended 1974 (S.I. 1975 No. 426).

41tt. Double Taxation Relief (Mauritius) Order 1981 (S.I. 1981 No. 1121).

41uu. Double Taxation Relief (Montserrat) Order 1947 (S.I. 1947 No. 2868), amended 1968 (S.I. 1968 No. 576).

41vv. Double Taxation Relief (Namibia) Order 1962 (S.I. 1962 No. 2352), extended 1962 (S.I. 1962 No. 2788), protocol 1967 (S.I. 1967 No. 1489), extended 1967 (S.I. 1967 No. 1460).

41ww. Double Taxation Relief (Netherlands) Order 1980 (S.I. 1980 No. 1961), protocol 1983 (S.I. 1983 No. 1902).

41xx. Double Taxation Relief (Netherlands Antilles) Order 1967 (S.I. 1968 No. 577), extended 1970 (S.I. 1970 No. 1949).

41yy. Double Taxation Relief (New Zealand) Order 1983, exchange of notes 1983 (S.I. 1984 No. 365).

41zz. Double Taxation Relief (Norway) Order 1985 (S.I. 1985 No. 1998).

41aaa. Double Taxation Relief (Pakistan) Order 1961 (S.I. 1961 No. 2467).

41bbb. Double Taxation Relief (Philippines) Order 1976 (S.I. 1978 No. 184).

41ccc. Double Taxation Relief (Poland) Order 1976 (S.I. 1978 No. 282).

41ddd. Double Taxation Relief (Portugal) Order 1968 (S.I. 1969 No. 599).

41eee. Double Taxation Relief (Romania) Order 1975, exchange of notes 1976 (S.I. 1977 No. 57).

41fff. Double Taxation Relief (St. Christopher & Nevis (St. Kitts)) Order 1947 (S.I. 1947 No. 2872).

41ggg. Double Taxation Relief (St. Lucia) Order 1949 (S.I. 1949 No. 366), amended 1968 (S.I. 1968 No. 1102).

41hhh. Double Taxation Relief (St. Vincent & Grenadines) Order 1949 (S.I. 1949 No. 367), amended 1968 (S.I. 1968 No. 1103).

41iii. Double Taxation Relief (Sierra Leone) Order 1947 (S.I. 1947 No. 2873), amended 1968 (S.I. 1968 No. 1104).

41jjj. Double Taxation Relief (Singapore) Order 1966 (S.I. 1967 No. 483), protocol 1975, exchange of notes 1975, 1976, 1977 (S.I. 1978 No. 787).

41kkk. Double Taxation Relief (Solomon Islands) Order 1950 (S.I. 1950 No. 748), amended 1968 (S.I. 1968 No. 574), amended 1974 (S.I. 1974 No. 1270).

41lll. Double Taxation Relief (South Africa) Order 1968 (S.I. 1969 No. 864).

41mmm. Double Taxation Relief (Spain) 1975 (S.I. 1976 No. 1919).

41nnn. Double Taxation Relief (Sri Lanka) Order 1979, exchange of notes 1980 (S.I. 1980 No. 713).

41ooo. Double Taxation Relief (Sudan) Order 1975 (S.I. 1979 No. 1719).

41ppp. Double Taxation Relief (Swaziland) Order 1968 (S.I. 1968 No. 380).

41qqq. Double Taxation Relief (Sweden) Order 1983 (S.I. 1984 No. 366), protocol 1984 (S.I. 1984 No. 366).

41rrr. Double Taxation Relief (Switzerland) Order 1977 (S.I. 1978 No. 1408), protocol 1981 (S.I. 1982 No. 714).

41sss. Double Taxation Relief (Thailand) Order 1981 (S.I. 1981 No. 1546).

41ttt. Double Taxation Relief (Trinidad & Tobago) Order 1982 (S.I. 1983 No. 1903).

41uuu. Double Taxation Relief (Tunisia) Order 1982 (S.I. 1984 No. 1336).

41vvv. Double Taxation Relief (Uganda) Order 1952 (S.I. 1952 No. 1213).

41www. Double Taxation Relief (United States of America) Order 1975, exchange of notes 1976, protocol 1976, protocol 1977, protocol 1979 (S.I. 1980 No. 568).

41xxx. Double Taxation Relief (Yugoslavia) Order 1981 (S.I. 1981 No. 1815).

41yyy. Double Taxation Relief (Zambia) Order 1972 (S.I. 1972 No. 1721), protocol 1981 (S.I. 1981 No. 1816).

41zzz. Double Taxation Relief (Zimbabwe) Order 1982 (S.I. 1982 No. 1842)).

42. By an exchange of notes dated September 26, 1980, between the Honorable Allan J. MacEachen, Deputy Prime Minister and Minister of Finance of Canada and G. William Miller,

Secretary of Treasury of the United States, in conjunction with the execution of the Convention For Avoidance of Double Taxation between the United States and Canada, the Government of Canada set forth its position on the issue of the so-called "unitary apportionment" method used by certain states of the United States and the United States agreed to reopen discussions with Canada on this subject if an acceptable provision on this subject can be devised.

43. By an exchange of notes dated November 24, 1978, between George S. Vest, Assistant Secretary of State for European Affairs, and Francois de Laboulaye, Ambassador of France, in conjunction with the execution of the protocol dated November 24, 1978, to the Convention for the Avoidance of Double Taxation between the United States and France, the Government of France set forth its position on the so-called "unitary apportionment" method used by certain states of the United States, and the Government of the United States and the Government of the United States agreed to reopen discussions with France on this subject if an acceptable provision on this subject can be devised.

44. In 1963, the Committee on Fiscal Affairs to the Council of the Organization for Economic Co-operation and Development ("OECD") published the Draft Double Taxation Convention on Income and Capital. In 1977, the OECD revised and published its new Model Double Taxation Convention on Income and on Capital. The conventions are both contained in the 1977 Report of the OECD Committee on Fiscal Affairs, "Model Double Taxation Convention on Income and on Capital."

45. In 1977, the Government of the United States of America published its Model Convention For the Avoidance of Double Taxation on Income and Capital. This document was revised in 1981 and is entitled "United States Draft Model Income Tax Treaty."

46. Correspondence, statements or press releases from various government officials throughout the United States have been issued, some of which are as follows:

46a. Letter from Secretary of Treasury, James A. Baker III to the President of the United States Senate regarding the introduction of Unitary Tax Repealer Act, dated December 18, 1985.

46b. Letter from the Honorable Barber B. Conable, Jr. to the Honorable John E. Chapoton with enclosed statement of the Honorable Conable to be submitted to the Unitary Taxation Group's Task Force, dated November 23, 1983.

46c. Letter to the Honorable Barber B. Conable, Jr. from the Honorable Donald C. Lubick, Assistant Secretary of the Treasury regarding unitary taxation, dated April 22, 1980.

46d. Statement by the Honorable Allen Wallis, Under Secretary of State for Economic Affairs concerning the Chairman's Working Group Report, as taken from the Final Report of the Worldwide Unitary Taxation Group, August 1984.

46e. Statement by the Honorable Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy, before the Senate Finance Subcommittee on Taxation and Debt Management Generally on S. 983 and S. 1688, dated June 24, 1980.

46f. Statement by the Honorable Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy, before the House Ways and Means Committee on H.R. 5076, dated March 31, 1980.

46g. Press release #255 from the Office of the Governor of California regarding California's unitary tax, dated May 1, 1984.

46h. Letter from the Honorable George P. Schultz to the Honorable George Deukmejian regarding unitary taxation, dated January 30, 1986

46i. Reply from Honorable George Deukmejian to the letter of January 30, 1986, from the Honorable George P. Schultz.

47. The Organization for Economic Co-operation and Development (OECD) issued a report on transfer pricing entitled "Transfer Pricing and Multinational Enterprises" (Paris OECD, 1979).

48. The Organization for Economic Co-operation and Development (OECD) issued a report on transfer pricing entitled "Transfer Pricing and Multinational Enterprises, Three Taxation Issues" (Paris OECD, 1984).

49. The administration of Internal Revenue Code Section 482 by the Internal Revenue Service, and its effectiveness generally, has been studied and reported on by certain governmental agencies of the United States, as follows:

49a. Comptroller General of the United States, No. GGD-51-81, Report to the Chairman, House Committee on Ways and Means, IRS Could Better Protect U.S. Tax Interests in Determining the Income of Multinational Corporations (September 30, 1981).

49b. Report to the Associate Commissioner of the Internal Revenue Service, Internal Revenue Service of Study of International Cases Involving Section 482 of the Internal Revenue Code (1982).

50. State taxation of multinational corporations has been the subject of reports, some of which are:

50a. "Key Issues Affecting State Taxation of Multi-jurisdictional Corporate Income Need Resolving", a report to the Chairman of the House Committee on Ways and Means from the Comptroller General of

the United States and published on July 1, 1982 in the General Accounting Office.

50b. Report of the Advisory Commission on Intergovernmental Relations, "State Taxation of Multi-national Corporations" dated November 1982.

50c. Report of Advisory On Intergovernmental Relations, "State Taxation of Multinational and Multistate Corporations" dated September 4, 1981.

51. Internal records of members of the Barclays Group were produced by plaintiffs to defendants in discovery, some of which are as follows:

51a. Letter from A. H. Dalton to I. M. Cobbold, Esq., dated August 3, 1979. (000176-000177)

51b. Letter from P. J. Chapman to G. J. Lyall, Esq., dated April 13, 1983. (000594-000595)

51c. Letter from Price Waterhouse to Secretary, Inland Revenue, dated April 1, 1982. (000631-000633)

51d. Letter from J. A. Dally to Price Waterhouse, dated May 13, 1982. (000630)

51e. BBL Reports and Accounts — 1977. (000256-000308)

51f. BBI Reports and Accounts — 1977. (000221-000255)

51g. Preliminary Prospectus dated March 31, 1981 $125,000,000 Barclays North American Capital Corporation % Guaranteed Capital Notes due 2006. (000424-000521)

51h. Barclays International-World of Banking — List of Offices Nov. 1977. (000309-000423)

51i. Barclays Bank International Limited claim for double tax relief — September 30, 1977. (000639-000646)

51j. Reconciliation between agreed local taxable profit and UK adjusted profit for purposes of double tax relief September 30, 1977. (000801-000828)

51k. A-T Schedule for Barclays Bank of California for the income year 1977. (002064-002092)

51l. Annual Return/Report of Employee Benefit Plan — U.S. Form 5500 and supporting documents. (003131-003160)

51m. Barclays Bank of California U.S. Corporation Income Tax Return for Income Year 1977 — U.S. Form 1120 and supporting documents. (003261-003209)

51n. BBI U.S. Corporate Income Tax for Income Year 1977 — Form 1120F. (003217-003225)

51o. Barclays Bank of California — California tax return for income year ending September 30, 1977. (003266-003250)

51p. BBI California tax return for income year ending September 30, 1977. (003251-003261)

51q. Barclays Group Management Accounts — December 31, 1977. (003610-003614)

51r. Barclays Group-Supporting schedules to financial accounts December 31, 1977. (003615-003629)

51s. The Barclays Group-Divisional Operating Profit; Reconciliation of Financial and Management Results. (003630-003687)

51t. Interest in subsidiaries and associated companies, December 31, 1977.

51u. Consolidation Schedules. (003708-003752)

51v. Letter D. Elvidge, Head Group Taxation Barclays Plc to J.H. Hall, Inland Revenue dated April 14, 1986.

51w. Letter J.H. Hall, Inland Revenue to David Elvidge, Head Group Taxation Barclays Plc, dated April 16, 1986.

This stipulation is made this 9th day of September, 1986.

JOANNE M. GARVEY
LAWRENCE W. JORDAN, JR.
JOAN K. IRION
JORDAN, KEELER & SELIGMAN

By ______________________
Joanne M. Garvey
Counsel for Plaintiffs

JOHN VAN DE KAMP,
Attorney General of the State of California
EDWARD P. HOLLINGSHEAD,
Supervising Deputy Attorney General

By ______________________
Robert Milam
Deputy Attorney General
Counsel for Defendant

CERTIFICATE OF SERVICE BY MAIL

I, Rhoda L. Fone, declare that I am a citizen of the United States, over the age of 18, and not a party to or interested in the within entitled cause; that I am an employee of JORDAN, KEELER & SELIGMAN, and that my business address is 1400 Alcoa Building, One Maritime Plaza, San Francisco, California 94111; that on November 3, 1986, I served the within JOINT STIPULATION OF FACTS by placing a true copy thereof in a sealed envelope with postage fully prepaid, in the United States Post Office mail box, in the City and County of San Francisco, California addressed as follows:

Robert D. Milam, Esq.
Deputy Attorney General
1515 K Street
Sacramento, California 94244-2550

I declare under penalty of perjury that the foregoing is true and correct.

Executed on November 3, 1986, at San Francisco, California.

____
Rhoda L. Fone

EXHIBIT 2

JOHN K. VAN DE KAMP, Attorney
General of the State of California
TIMOTHY G. LADDISH
Supervising Deputy Attorney General
RICHARD E. NEILSEN
ROBERT D. MILAM
Deputy Attorneys General
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Telephone: (916) 324-5156
ATTORNEYS FOR DEFENDANT

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SACRAMENTO

BARCLAYS BANK INTERNATIONAL LTD.,
a corporation of the Country of England,
Plaintiff,

vs.

FRANCHISE TAX BOARD,
an agency of the State of California,
Defendant.

Barclays Bank of California
a California Corporation,
Plaintiff,

vs.

FRANCHISE TAX BOARD,
an agency of the State of California,
Defendant.

No. 325059

No. 325061

(Consolidated for Purposes of Trial)

SECOND STIPULATION OF FACTS AND DOCUMENTS

IT IS HEREBY STIPULATED by and between the parties, through their attorneys of record, that the following further facts and documents are agreed to and undisputed. This stipulation shall not be construed as a concession by either party of the relevancy or materiality of any of the facts stipulated, and the parties reserve the right to argue the relevance, materiality or weight of any of the facts stipulated.

All further documents referred to herein or specifically enumerated are compiled under separate cover, have been reviewed by counsel for the parties and their authenticity and foundational basis admitted. The documents shall be entered into evidence. Nothing contained in this stipulation shall prevent a party from introducing at trial any other or further evidence. With permission of Court, documents described in paragraphs 32, 40, and 41 hereof will be deemed admitted in evidence in entirety without physically presenting the same at trial. Either party may refer to said documents in summary form or as individual exhibits at trial or on appeal as evidence admitted at trial.

Nothing contained herein shall be construed as a waiver by any party of its right to review on appeal any question of law or fact arising in this action in the same manner and to the same extent as if the facts set forth herein had been proven in open court.

This stipulation shall only apply to the above-entitled consolidated actions and to any appeals from the judgment of this Court.

FACTS AND DOCUMENTS

The following facts are agreed to and undisputed and the following documents shall be entered into evidence:

28. Continued

28a. Announcement of the Establishment of the Working Group. 48 Fed. Reg. No. 208, page 49570, October 26, 1983.

32. Continued

32ff. Demarche from Greece, as President of the EEC, on behalf of the Ten European Economic Community Governments to the Department of State, Washington D.C. dated September 23, 1983 with attached Note.

32gg. Aide-memoire from the Government of Japan to the United States Government, dated August 11, 1983.

32hh. Demarche from the Embassy of Ireland as President of the EEC, on behalf of the governments of member states and the Commission of the European Communities to the Department of State, dated December 20, 1984.

32ii. Note Verbale of the Delegation of the Commission of the European Communities and the Embassy of Luxembourg on behalf of the EEC, to the Department of State, dated August 8, 1985.

32jj. Demarche from the Ambassador of Luxembourg and the Head of the Delegation of the Commission of the European Communities to the Department of State, dated August 30, 1985 with attached letter to Treasury Secretary Baker dated August 30, 1985 and attached Note Verbal.

32kk. Note on Worldwide Unitary Taxation from J. Raoul Schoumaker, Ambassador of Belgium, on behalf of the Member States of the European Commission and the Ambassador of Australia, Canada, Japan and Switzerland to Under Secretary of State Allen Wallis and Treasury Secretary Donald Regan, dated January 27, 1984 with cover letter, dated January 30, 1984, enclosing the same to Sir Roy Denman, Head of the Delegation of the Commission of the European Communities.

32ll. Motion for Resolution of the EEC dated October 27, 1983.

37. Continued

37h. Hearing before the Committee on Foreign Relations of the United States Senate on Six International Tax Treaties and Protocols, 96th Congress, 1st Sess. (June 6, 1979).

37i. Hearing before the Subcommittee on Taxation and Debt Management of the Congress on Finance on S.1113 and S.1974, 99th Congress, 2d Sess. (September 29, 1986).

46. Continued

46j. Letter from Michael Blumenthal, Secretary of Treasury to Martin Huff, Executive Officer California Franchise Tax Board, February 15, 1977.

46k. Letter from John S. Chapoton, Assistant Secretary Treasury (Tax Policy) to William J. Anderson, Director, General Government Division U.S., GAO Washington D.C., dated July 10, 1981.

46l. Letter from Donald Regan, Secretary of Treasury, to William Brock, United States Trade Representative, dated February 12, 1982.

46m. Letter from William Brock, United States Trade Representative to Donald Regan, Secretary of Treasury, dated February 22, 1982

46n. Letter from Treasury Secretary James A. Baker III to House Ways and Means Committee Chairman, Dan Rostenkowski, dated March 5, 1986.

46o. Letter from Treasury Secretary James A. Baker III to Senate Finance Committee Chairman Bob Packwood, dated March 17, 1986.

46p. Letter from Treasury Secretary James A. Baker III to Speaker of the House of Representatives, Hon. Thomas P. O'Neill, Jr., dated December 18, 1985.

51. Continued

51x. BBI 1977 New York State Tax Return (Doc. No. 32678-3271).

53. The United Nations Model Double Taxation Convention Between Developed and Developing Countries, 1980.

54. United Kingdom Government Statement in Response to the Statement of the President dated November 8, 1985.

55. California Senate Bill 85 (Alquist) signed by Governor Deukmejian September 5, 1986, an act to add Chapter 1.9 (commencing with Section 15365), Chapter 6 (commencing with Section 15397), and Chapter 7 (commencing with Section 15398) to Part 6.7 of Division 3 of, and to add Article 12 (commencing with Section 16429.30) to Chapter 2 of Part 2 of Division 4 of, Title 2 of, the Government Code, to amend Sections 24274, 24344, 24348, 24667, and 24668 of, to amend and renumber Section 25110 of, to add Sections 24411 and 24670 to, and to add and repeal Article 1.5 (commencing with Section 25110) of Chapter 17 of Part 11 of Division 2 of, the Revenue and Taxation Code, relating to taxation.

56. United Kingdom Government Statement in Response to passage of Senate Bill 85, dated 5 September 1986.

57. Memo to File from Benjamin F. Miller regarding UDITPA Regulations 25137(m) and 25137(o) dated September 23, 1981 with attached Proposed Guidelines for the Preparation of Combined Reports which Include Foreign Country Operations.

58. Summary of Comments, Responses and Recommendations on Proposed Regulation 25137(m) Combined Reports Including Foreign Country Operation.

59. Summary of Comments Received Regarding FTB 1046 (12-79) and Department Responses.

60. US/USSR Treaty hearings and documents including letter from George Shultz to Nikolai Patolicher, Report of the Department of State, and the Report of the Senate Foreign Relations Committee.

This stipulation is made this 10th day of November, 1986.

JOANNE M. GARVEY
LAWRENCE W. JORDAN, JR.
JOAN K. IRION
JORDAN, KEELER & SELIGMAN

By ____________________
Joanne M. Garvey
Counsel for Plaintiffs

JOHN VAN DE KAMP,
Attorney General of the State of California
EDWARD P. HOLLINGSHEAD,
Supervising Deputy Attorney General

By ____________________
Robert Milam
Deputy Attorney General
Counsel for Defendant

EXHIBIT 12

[¶ 14-834F] Section 25137-6 [Reg. 25137-6 — CCH.] *Combined Reports Including Foreign Country Operations* — (a) In General.

(1) Unitary Business. A taxpayer is engaged in a unitary business (or a single business within the meaning of Reg. 25120(b)) when its activities within the state contribute to or are dependent upon its activities without the state. A unitary business exists when there is unity of ownership, unity of operation and unity of use.

(2) Translation Method for Determining Income. The translation method to be used for determining income shall be the "profit and loss method" as set forth in this regulation. This method excludes unrealized exchange rate gain or loss resulting from the restatement of assets or liabilities, while taking into account exchange gains or losses attributable to income transactions.

(3) General Applicability of UDITPA Regulations. The general regulations for UDITPA, Regs. 25120 — 25139, inclusive, shall be applicable except as otherwise provided in this regulation.

(b) Determination of Income.

(1) The income of a unitary business with operations in foreign countries shall be computed in the following manner:

(A) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained.

(B) Adjustments shall be made to the profit and loss statements to conform it to the accounting principles generally accepted in the United States for the preparation of such statements except as modified by this regulation.

(C) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards required under Division 2 Part 11 of the Revenue and Taxation Code.

(D) The profit and loss statement of each branch or corporation, whether U.S. or foreign, shall be translated into currency in which the parent company maintains its books and records in accordance with subsection (b)(4).

(E) Business and nonbusiness income as determined under California law shall be identified and segregated. For general definition, rules and examples for determining business and nonbusiness income, see Regulation 25120.

(F) Nonbusiness income shall be allocated to a specific state pursuant to the provisions of Sections 25124 to 25127, inclusive of Division 2 Part 11 of the Revenue and Taxation Code.

(G) Business income shall be included in the combined report prepared for the unitary business and shall be apportioned on the basis of the appropriate formula for the business.

(H) Income from California sources shall be expressed in dollars in accordance with subsection (b)(4) and the taxes computed accordingly.

(2) In lieu of the procedures set forth in subsection (b)(1) and subject to the determination of the Franchise Tax Board that it reasonably reflects income, a unitary business with operations in a foreign country may determine its income on the basis of the consolidated profit and loss statement prepared for the related corporations of which the unitary business is a member which is prepared for filing with the Securities and Exchange Commission. If the business is not required to file with the Securities and Exchange Commission, the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor may be used.

(A) Adjustments shall be made, if necessary to:

(i) conform to the accounting principles generally accepted in the United States for the preparation of such statements, except as modified by this regulation;

(ii) conform to the tax accounting standards as required under Division 2 Part 11 of the California Revenue and Taxation Code; and

(iii) eliminate unrealized gain and losses resulting from the restatement or revaluation of assets or liabilities to reflect changes or fluctuations in currency values.

(B) Business and nonbusiness income as determined under California law shall be identified and segregated. For definitions, rules and examples for determining business and nonbusiness income, see generally Regulation 25120.

(C) Nonbusiness income shall be allocated to specific states pursuant to the provisions of Section 25124 to 25127, inclusive of the Revenue and Taxation Code.

(D) Business income shall be included in the combined report prepared for each unitary business and will be apportioned on the basis of the appropriate formula for each business.

(E) Income from California sources shall be expressed in dollars in accordance with subsection (b)(4) and the taxes computed accordingly.

(3) For purposes of subsections (b)(1)(B), (b)(1)(C), and (b)(2)(A), the following rules shall apply:

(A) Accounting adjustments to be made to conform profit and loss statements to those utilized in the United States —

(i) Include but are not limited to the following:

(I) Clear reflection of income. Any accounting practice designed for purposes other than the clear reflection on a current basis of income and expense for the taxable year shall not be given effect. For example, an adjustment shall be required where an allocation is made to an arbitrary reserve out of current income.

(II) Physical assets, depreciation, etc. All physical assets, including inventory when reflected at cost, shall be taken into account at historical cost computed either for individual assets or groups of similar assets. The historical cost of such an asset shall not reflect any appreciation or depreciation in its value or in the relative value of the currency in which its cost was incurred. Depreciation, depletion, and amortization allowances shall be based on the historical cost of the underlying asset, and no effect shall be given to any such allowance determined on the basis of a factor other than historical cost.

(III) Valuation of assets and liabilities. Any accounting practice which results in the systematic undervaluation of assets or overvaluation of liabilities shall not be given effect, even though expressly permitted or required under foreign law, except to the extent allowable under subsection (b)(3)(B). For example, an adjustment shall be required where inventory is written down below market value.

(IV) Income equalization. Income and expense shall be taken into account without regard to equalization over more than one accounting period; and any equalization reserve or similar provision affecting income or expense shall not be given effect, even though expressly permitted or required under foreign law.

(ii) Currency gains or losses on closed transaction are includible, but no adjustments shall be made, or otherwise reflected, for unrealized gains or losses resulting from the restatement or revaluation of assets or liabilities to reflect changes or fluctuations in currency values. A closed transaction is one where any foreign exchange position taken by a corporation has been terminated by exchanging the foreign currency for the currency in which the individual corporation maintains its books and records and normally conducts its business affairs. In the case of a borrowing in a foreign currency, the transaction shall not be deemed closed until repayment is made.

(B) The tax accounting adjustments to be made shall include, but are not limited to, the following:

(i) Accounting methods. The method of accounting shall reflect the provisions of Section 24651 of the Revenue and Taxation Code and the regulations thereunder.

(ii) Inventories. Inventories shall be taken into account in accordance with the provisions of Section 24701 through 24706 of the Revenue and Taxation Code and the regulations thereunder, except Regulation 24702 — 24706(b)(5).

(iii) Depreciation, depletion, and amortization. Depreciation, depletion, and amortization are to be computed in accordance with California law.

(iv) Elections.

(I) Elections required to be made for purposes of determining income under Division 2 Part 11 of the Revenue and Taxation Code of all California reporting entities shall be made in accordance with applicable provisions of such law and the regulations adopted pursuant thereto.

(II) Elections required to be made for purposes of determining income under Division 2 Part 11 of the Revenue and Taxation Code for entities which are not subject to taxation by California but are required to be included in the combined report for the unitary business shall be made by agreement of all entities required to report to California in accordance with applicable provisions of such law and the regulations adopted pursuant thereto. If agreement cannot be reached, such income shall be reported on the basis of United States generally accepted accounting principles.

(C) No adjustment shall be required under subsections (b)(3)(A) and (b)(3)(B) unless it is material. Whether an adjustment is material depends upon the facts and circumstances of the particular case, including the amount of the adjustment, its size relative to the general level of the corporation's total assets and annual profit or loss, the consistency with which the practice has been applied, and whether the item to which the adjustment relates is of a recurring or a nonrecurring nature.

(4) For purposes of determining income, necessary translations shall be made at the following exchange rates:

(A) Depreciation, depletion or amortization shall be translated at the appropriate exchange rate for the translation period in which the historical cost of the underlying asset was incurred.

(B) All other items shall be translated at either the end-of-year exchange rate or at the simple average exchange rate for the translation period. Income repatriated during the year shall be translated at the exchange rate at date of repatriation. It is

presumed that the translation rate used in preparing the consolidated profit and loss statement for financial reporting purposes is proper absent a showing that some other method is appropriate.

A change from end-of-year rates or average rates may not be made without the permission of and on such conditions as the Franchise Tax Board may prescribe.

(C) Computation of Factors. In computing the formula factors, the following rules shall apply:

(1) Property Factor.

(A) Fixed assets shall be valued at original cost as defined in Reg. 25130(a) and translated at the exchange rate as of the date of acquisition.

(B) Rented property, capitalized at eight times its annual rental rate, shall be translated at the simple average of the beginning and end-of-year exchange rate.

(C) Inventories shall be valued at original cost and shall be translated at the exchange rate as of the date of acquisition.

(D) For purposes of calculating the property factor of financial corporations, financial assets are translated at the year-end rate and are defined as assets reflecting a fixed amount of currency, such as cash on hand, bank deposits, and loans and accounts receivable. Securities held, or reasonably expected to be held, for less than six months shall be translated at year-end rates. If a security is held, or reasonably expected to be held, for more than six months, it shall be translated at the appropriate exchange rate for the translation period in which the historical cost of the asset is determined.

(E) The property factor shall be computed in the currency of the parent company unless the taxpayer requests and the Franchise Tax Board determines that computing the factor in dollars or any other currency fairly reflects the taxpayer's activities in California.

(2) Payroll and Receipts Factors.

(A) Translation shall be made at the simple average of the beginning and end-of-year exchange rates unless there is a substantial fluctuation, as described in subsection (d)(2).

(B) Where the value of the foreign currency does fluctuate substantially, as described in subsection (d)(2) the exchange rate appropriate to that period shall be either (1) a simple average of the month-end rates, or (2) a weighted average taking into account the volume of transactions (reflected by the amount being translated) for the calendar months ending with or within that period.

(C) In computing the payroll and receipts factors, translation shall be made into the parent company's currency in order to properly determine the percentage factor to be used unless the taxpayer requests and the Franchise Tax Board determines that computing the factors in dollars or any other currency fairly reflects the taxpayer's activities in California.

(d) Exchange Rates.

(1) For purposes of preparing combined reports, exchange rates may be derived from any source which is demonstrated to the satisfaction of the Franchise Tax Board to reflect actual transactions conducted in a free market and involving representative amounts. In the absence of such demonstration, the exchange rates taken into account in computation of the earnings and profits of the foreign corporation shall be determined by reference to the free market rate set forth in the pertinent monthly issues of *International Financial Statistics* or successor publications of the International Monetary Fund.

(2) In general, the extent of fluctuation is substantial if the closing rate for any calendar month ending within the period varies by more than 10 percent from the closing rate for any preceding calendar month ending within the period.

(e) Application of Regulation.

(1) In computing the income and any of the factors required for a combined report, the Franchise Tax Board shall consider the

effort and expense required to obtain the necessary information. In appropriate cases, such as when the necessary data cannot be developed from financial records maintained in the regular course of business, the Franchise Tax Board may accept reasonable approximations.

(2) A taxpayer may request an advance determination under subsections (b)(2), (b)(3)(C), (c)(1), (d)(1) or any other provision of this regulation by submitting a determination request to the Legal Division of the Franchise Tax Board. Such a determination shall be made on an individual basis and shall be limited to the particular facts or circumstances set forth in the determination request. The facts and circumstances upon which a determination is made remain subject to review. Failure to request or to obtain a favorable advance determination will not preclude consideration of requested variances in subsequent procedures.

Note: Authority cited: Section 26422, Revenue and Taxation Code.
Reference: Section 25137, Revenue and Taxation Code.

(Applicable for income years beginning after December 31, 1972; amended effective March 27, 1985.)

EXHIBIT 13

COSTS OF COMPLIANCE FOR CALIFORNIA WORLDWIDE COMBINED REPORT

SET-UP	
Analysis of information available and information needed	$ 255,000
Design of tax package for subsidiary and branches	85,000
Implementation and training	340,000
Create computer program and information base:	
Fixed Assets	1,615,000
Securities	680,000
Leased assets	680,000
Bad debts	170,000
Other items (e.g. rentals, reserves, intangible assets, non-performing loans)	850,000
TOTAL STAFF COSTS	$4,675,000
Cost of systems set-up and processing	3,000,000
TOTAL PROJECTED SET-UP COSTS	$7,675,000

ANNUAL COMPLIANCE	
Identification and segregation of business and non-business income under California law	$ 340,000
Fixed assets	425,000
Securities	255,000
Leased assets	255,000
Bad debts	85,000
Other differences between book and tax accounting (see Exhibit 6)	680,000
TOTAL STAFF COSTS	$2,040,000
Cost of systems processing	1,000,000
TOTAL PROJECTED ANNUAL COMPLIANCE COSTS	$3,040,000

MAINTENANCE AND TRAINING	
Monitoring tax and accounting changes	$ 85,000
Updating tax package and systems	255,000
Annual training for changes and new personnel	85,000
TOTAL STAFF COSTS	$ 425,000
Cost of systems processing	300,000
TOTAL PROJECTED ANNUAL MAINTENANCE AND TRAINING COSTS	$ 725,000

EXHIBIT 14

COSTS OF COMPLIANCE FOR CALIFORNIA WORLDWIDE COMBINED REPORT

Barclays Bank International Limited (BBI) and Barclays Bank of California (Barcal) are members of the Barclays Group, a United Kingdom based group of corporations headed by Barclays PLC and composed of approximately 300 subsidiaries, including Barcal and BBI (BBI is now Barclays Bank PLC as a result of a merger in 1985. However, to avoid confusion, references will be made to BBI). The term "Barclays Group" is used in this report to refer to the aforementioned parent company Barclays PLC and all its subsidiaries, direct and indirect.

The Barclays Group presently has offices in over 80 countries. BBI itself operates directly (through branches or agencies) in over 31 countries. Although the general business of the Barclays Group might be described as banking, the Barclays Group also includes entities involved in insurance, merchant banking, factoring, mortgage banking, trust company operations, unit trust (mutual funds) management, consumer finance and leasing activities.

The California Revenue and Taxation Code and regulations, and particularly Reg. Section 25137-6, set forth the requirements for filing California combined reports that include foreign company operations. If a taxpayer is involved in a unitary business with related entities, it must file a combined report setting forth the aggregate worldwide business income and non-business income of those entities which comprise the unitary business. The California share of the worldwide income is determined by first apportioning to California a percentage of the business income based upon:

$$\frac{\frac{\text{CA. Payroll}}{\text{WW Payroll}} + \frac{\text{CA. Property}}{\text{WW Property}} + \frac{\text{CA. Receipts}}{\text{W Receipts}}}{3}$$

The nonbusiness income is allocated in accordance with the rules set forth in the Revenue and Taxation Code and regulations.

To prepare the combined report, the information required under the Code and regulations for the filing of a worldwide combined return, and specifically the provisions of Reg. Section 25137-6, the information centrally collected by the Barclays Group and the procedures presently utilized to collect information within the Barclays Group were reviewed. The following costs, set forth in greater detail on Exhibit 1, would have to be incurred to comply with the California worldwide reporting requirements. These costs would be incurred exclusively for purposes of such compliance and would not otherwise be incurred by the Barclays Group for any other purpose:

Initial Set Up Costs	$7,675,000
Annual Compliance Costs	$3,040,000
Maintenance and Training	$ 725,000

1. *Information Presently Collected By the Barclays Group*

The Barclays Group presently collects certain financial information for the purposes of filing its annual report to its shareholders.

The information presented in the annual report is rounded to the millions (000,000) of U.K. pounds sterling.

Summary information is collected at various levels within the Barclays Group and is forwarded to the Chief Accountant's Office for purposes of the preparation of the annual report. The Barclays Group does not maintain central books and records of the various subsidiaries and does not require non-U.K. subsidiaries to maintain accounts in sterling. Only those entities operating in the U.S. and the Virgin Islands maintain their accounts in U.S. dollars.

The Barclays Group collects information on the branch operations on Standard Accounting Schedules, Branches, and on subsidiaries on Standard Accounting Schedules, Subsidiaries. The subsidiary information is rounded to the thousands (000) and the schedules are in summary form. Copies of these forms are attached as Exhibits 2 and 3, respectively.

The information centrally collected and available is not sufficient to properly prepare a California combined report including

foreign company operations. In order to properly prepare a tax return, a taxpayer may not rely solely on the information contained in its financial statements or make a few adjustments to the income on its profit and loss statement to arrive at taxable income. Financial accounting and tax accounting differ in that what is considered acceptable for one (such as rounding to the thousands or even millions of pounds as set forth in the taxpayer's annual report or the timing, treatment and availability of income or deductions) will not be acceptable for the other. The accepted procedure to arrive at taxable income is to identify those areas where tax accounting standards differ from generally accepted accounting principles and then go directly to the detailed source information (e.g., the general ledger, the property listing, the payroll records, the employee expense reports, etc.) to calculate the correct amount of income or deduction to be used for tax purposes. For an indication of the areas that must be considered in preparing a U.S. income tax return, see an attached checklist for corporate taxpayers (Exhibit 4) and an aditional tax checklist applicable to commercial banks (Exhibit 5). Some of the areas where tax and book calculations are likely to differ under United States principles are set forth in Exhibit 6.

However, the Barclays Group information is collected in accordance with the United Kingdom standard accounting practices in order to file an annual report in the United Kingdom. No analysis has been done on the differences between California, or even the United States, tax accounting rules and the financial accounting methods of the United Kingdom.

Except for the California tax, the Barclays Group would have no reason to ascertain any such differences. A group of corporations, with its home office in a foreign country and with subsidiaries or branch operations in the United States, is subject to federal income tax only on income arising from its activities in the United States. The United States has adopted, both in treaties and in its statutes and regulations, the internationally recognized and used standard of separate accounting. As a result, a foreign-based taxpayer does not provide information on its non-U.S. operations or on the results of its subsidiaries operating exclusively outside the United States to the federal taxing authorities. Foreign-based

taxpayers have, therefore, not been required to establish a procedure which would gather information necessary to adjust non-U.S. operating results to U.S. tax accounting standards. It is only for the purposes of filing the California worldwide combined report that a foreign-based corporate group must accumulate information from all of its operations and subsidiaries throughout the world to permit calculation of income based on California tax accounting standards. In the case of the Barclays Group with approximately 5,000 offices and branches and subsidiaries in over 60 countries and currencies, the accumulation of specific information to permit reporting on the California tax accounting basis requires a commitment of resources to the task which would not be required for any other taxing jurisdiction. In other words, the costs of compliance with the California worldwide combined reporting method are incurred solely because of the California tax rules and would not be incurred if these rules did not apply beyond United States boundaries.

2. *System To Comply With California Requirements*

A proper system for compliance with the California combined reporting requirements has three cost components: (a) set-up, (b) annual compliance, and (c) maintenence of the system.

(a) Set-Up

The information presently collected and the system to collect such information are not oriented to the collection of tax information.

To create a proper system, it is necessary (i) to analyze the differences between California tax accounting standards and U.S. and U.K. generally accepted accounting principles, (ii) to determine what information is needed to calculate the adjustments from U.K. accounting principles to tax accounting standards, and (iii) to analyze what useful information might be available centrally and what information would be required from each of the operations and subsidiaries.

Next a "tax package," understandable by personnel at locations throughout the world and easily processed by computer, would need to be designed to collect the information. Computer pro-

grams would have to be designed to take the information provided by the responding locations and perform the necessary calculations to arrive at the adjustments for tax accounting purposes.

Finally, an initial data base of information essential to all future calculations for the California worldwide combined report would be created. This would include information regarding fixed assets, securities, leased assets (both by the Barclays Group and to customers), reserves and historical information for the tax bad debt deduction. For example, to comply with the requirements of Reg. Section 25137-6, the information needed on fixed assets would include the date of acquisition, the cost at date of acquisition in local currency, the exchange rate that existed at the date of acquisition between local currency and U.K. pounds sterling, the expected salvage value, the type of asset so that the asset can be placed in the proper depreciation classification for California tax purposes, and any assets which may not be currently recorded on the financial statements (e.g., assets which had been fully depreciated for financial purposes).

(b) *Annual Compliance*

Each year the tax package which had been developed as part of the set-up procedures would be sent to all operations and subsidiaries throughout the world. Central staff would review the information received for correctness and completeness, and, in those instances where questions arise, follow up with the locations. The separate location information would need to be combined into a useful format and this information would ultimately be used to compute the adjustments needed to report results under California tax accounting standards.

Specific detailed information would have to be requested and accumulated for each difference between the financial information and tax accounting information which had been identified in the original analysis. The level of an adjustment cannot be known without obtaining the detailed information for each identified book versus tax difference.

Business and nonbusiness income would have to be identified for allocations.

(c) *Maintenance*

The Barclays Groups would also be required to monitor changes to U.S. and California tax law and changes to U.S. and U.K. generally accepted accounting principles. Changes in the Barclays Group's activities and structures would need to be monitored to determine whether an entity was includible or excludable from the unitary group or whether there were separate unitary businesses. All changes would have to be incorporated into revisions to the tax package and the processing systems.

EXHIBIT 15

ACCOUNTING STEPS REQUIRED UNDER 18 CALIFORNIA ADMIN. CODE 25137-6

Method One (Subsection (3)(b)(1))

Foreign-Multinational Corporation	Domestic-Multinational Corporation
Preliminary Step — Step A: Profit & Loss Statement Prepared each Foreign Branch or Corp.	
Prepared in normal course.	Prepared in normal course.
Step B: Adjust P&L to U.S. Generally Accepted Practices (GAAP)	
Individual P&Ls must be adjusted from accounting practaices of locality where kept.	Prepared in normal course.
Step C: Adjust to Tax Accounting Standard of California	
Must be done. Must have knowledge of financial statement book differences from California Rules and then convert the P&L to California taxable income.	Prepared in normal course. Footnote disclosure is required for the amount of current liability for state taxes.
Step D: Profit & Loss each Branch or Corp. to Currency of Parent	
Prepared in normal course.	Prepared in normal course.
Step E: Business & Non-business Income Segregated	
Must be done.	Must be done.

Foreign-Multinational Corporation	Domestic-Multinational Corporation
Step F: Allocations of Non-business Income	
Must be done.	Must be done.
Step G: Income Apportioned on Basis of Formula	
Must be done. Must have knowledge of what apportionment factors are.	Prepared in normal course.
Step H: Convert Local Currency to Dollars	
Must be done.	Prepared in normal course.

EXHIBIT 30A

UNITED KINGDOM VERSUS UNITARY TAXATION

Statement of the United Kingdom before the United States Treasury Working Group on Worldwide Unitary Taxation*

Summary of principal points

A. Her Majesty's Government is opposed to the application of the unitary method of state taxation on a worldwide reporting basis.

B. The worldwide unitary method of state taxation is contrary to well established international principles and practice of taxation, and imposes unreasonable tax and administrative burdens on multinational corporate groups doing business throughout the world.

C. Unitary taxation is already damaging commercial and economic relations between the US and the UK and other countries. If it continues, the damage to international trading relations will become more serious. If unitary taxation spreads, the scale of the worldwide damage will be further increased.

D. In particular for UK companies unitary tax imposes significant additional burdens on both the companies and their shareholders. First it produces anomalous tax liabilities, which may be considerately larger than those calculated on the internationally-accepted arm's length basis. Second the requirements of the method involve additional compliance costs. In addition the uncertainty generated by the unitary method has disruptive effects on UK corporations' business activities and industrial investment.

E. As long as the worldwide unitary method persists, it will be impossible to achieve the essential economic objectives of providing a consistent and coherent tax framework for international

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trade and investment. Moreover, the damage to international trade and investment would be greatly increased if foreign Governments responded by imposing retaliatory measures or introducing unitary systems of their own.

I. INTRODUCTION

1. Almost two years ago, the United States Government advised the Supreme Court in its brief in the *Chicago Bridge & Iron Co.* case, that "the imposition of [a state tax] on the apportioned combined worldwide business income of a unitary group of related corporations impairs federal uniformity in an area where such uniformity is essential". That explicit pronouncement of United States policy is equally appropriate for today. Indeed, since that brief was filed, the threat to international business relations posed by the worldwide unitary method of state taxation has assumed even greater magnitude. At present 11 states employ the worldwide combined reporting system, namely Florida, California, Massachusetts, Oregon, Alaska, Idaho, Colorado, Montana, New Mexico, North Dakota and Utah. Approximately 70 per cent of the direct foreign investment in the United States comes from Western Europe. Hence, the burden of the unitary worldwide combined reporting system falls particularly heavily on European based corporations.

2. It is therefore hardly surprising that the unitary tax issue has been the subject of repeated diplomatic protests from other governments since 1979. On August 1, 1983, the 10 governments of the European Community delivered a diplomatic note to the United States Government renewing their objections to the international application of the unitary tax. Similar objections were expressed by the Japanese Government on August 11, the Netherlands Government on August 17, and the Canadian Government on August 23. Earlier protests against unitary taxation by these governments have been well publicised.

3. The United Kingdom has an interest even stronger than that of other Governments since the United Kingdom direct investment in the United States is greater than that of any other country. By 1982 the cumulative total of United Kingdom investment in the United States was $23.334 billion which accounted

for 23% of the foreign direct investment in the United States. Any measure which inhibits investment by British business in the United States is clearly to the detriment of both countries. Her Majesty's Government believes that unitary taxation already has a damaging effect on the business relations between the two countries and that the damage will become very serious if the issue is not speedily resovled.

4. The unitary method of taxation is wholly contrary to the agreed international method of attributing the profits of multinational enterprises between the countries in which they operate. This is the arm's-length method which seeks to ensure that profits of such enterprises are allocated in such a manner that each country is able to claim tax on the profits — and no more and no less than the profits — actually earned in that country. If all countries use the same arm's-length basis in determining the profits, then double taxation should be avoided through the international net-work of double taxation agreements.

5. Unitary taxation is incompatible with this internationally agreed method. It uses a formula to determine what sum shall be charged and, as practised in the States, it may include profits brought into charge elsewhere on the arm's-length basis. If unitary taxation were practised worldwide and every national state could use an identical formula for determining its share of the profits of a multinational enterprise then agreement might be reached internationally on such a basis which would eliminate double taxation. It is, however, the case that over the last 40 years or more the international community has devised and refined the arm's-length method for international use. It is in this context of worldwide agreement about the method of attributing profits to multinational companies that the use of a different method by some states of the United States causes a distortion which makes it internationally unacceptable.

6. It it for these reasons that Her Majesty's Government has consistently urged that action be taken to prevent the application of unitary taxation to United Kingdom businesses. It sought to do so when negotiating the current United Kingdom/United States Double Taxation Agreement: but when in 1979, the United States Senate ratified the Treaty it attached a reservation against this

provision in Article 9(4). That Article in its original form would have prevented the United States Government and the individual states from applying the unitary method to United Kingdom corporate groups which have subsidiary companies in the United States. In its final form, the Article applied only for purposes of the United States Federal tax, which does not employ the unitary method. At the time the United Kingdom, with the approval of Parliament, ratified the amended Treaty and accepted the Senate reservation against Article 9(4), Her Majesty's Government was given to understand that the Government of the United States would use its best endeavours to eliminate the application of the unitary method of taxation on a worldwide basis. Nevertheless, since then more states have adopted the worldwide unitary approach.

7. Attempts have been made concurrently to secure a solution through the United States Supreme courts without success. Last June the United States Supreme Court ruled in *Container Corporation v. Franchise Tax Board*, that the California worldwide unitary tax method did not violate the Foreign Commerce Clause of the United States Constitution as applied to a United States parent corporation and its foreign subsidiaires. In so holding, the Court specifically reserved the question of the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries.

8. In Her Majesty's Government view, the Court's decision in *Container Corporation* was an unfortunate setback that derived, in large measure, from the confusion caused by the failure of the United States Government to reaffirm the position taken in its original brief in the *Chicago Bridge* case, to which we have referred. In considering whether the California tax impaired federal uniformity and the conduct of United States foreign relations, the Court observed that the federal government's failure to file an amicus brief in the *Container* case suggested that "the foreign policy of the United States is not seriously threatened by California's decision to apply the unitary business concept and formula apportionment . . ." Hence, Her Majesty's Government believes that the outcome of the Court's sharply divided (5-3) decision could well have been different had the federal govern-

ment clearly restated what all parties originally understood to be its position.

9. Moreover, the likelihood of an early resolution of the applicability of the unitary method to the foreign parent corporation case reserved by the Supreme Court is very much in doubt. Attempts are being made to have the matter heard but two courts of appeal have dismissed suits by foreign corporations against the California Franchise Tax Board on the ground that those foreign entities lack "standing" to contest the tax assessments that are nominally addressed to their domestic subsidiaries. On the other hand, as domestic corporations, the subsidiaries cannot invoke the treaty provisions that are at the heart of the claim that the unitary method impairs the conduct of foreign relations. Hence, these court rulings render rights conferred by treaties unenforceable by the very entities those provisions were negotiated to protect companies of one treaty part engaged in this way in the territory of the other treaty party.

10. The denial of standing to raise claims under the United States Constitution will leave foreign parent companies which in fact bear the economic burden of double taxation caused by the unitary method unable to challenge the lawfulness of that burden. This may not be "taxation without representation" as it is usually understood. But it does amount to taxation without the right to be heard, in that a levy whose constitutionality is at issue cannot be challenged by a party directly affected by it. Reciprocally narrow rulings by foreign courts would weaken the ability of the United States companies to obtain judicial protection for their investments abroad.

11. In sum, the failure of both the treaty making process and federal litigation to resolve the validity of the worldwide unitary method makes it imperative that a comprehensive solution be reached as soon as practicable. It is Her Majesty's Government's view that this method is incompatible with the internationally accepted regime for taxing the profits of multinational enterprises.

II. CRITERIA FOR JUDGING A TAX SYSTEM

12. Any tax system should be judged on whether it is capable of being administered equitably, produces certainty and efficiency, and whether it is capable of simple operation. The effects of applying unitary tax on a worldwide basis are both *inequitable and uncertain*. Moreover it is *far from simple* for the companies concerned, since it requires a restatement in US terms of the income and formula factors for each component part of a group operating worldwide. These effects in turn constitute an element of *tax induced inefficiency* in the world economy, which will inevitably distort trade patterns and inhibit business decisions.

Application to differing economic circumstances

13. These adverse effects can be traced to particular aspects of applying the unitary basis to the conditions and circumstances which exist today. First, when applied on a worldwide basis, the unitary system is of necessity operating in economic conditions which are far from homogeneous. The system works by combining the income of several related corporations engaged in a "unitary" business. Income is then allocated to the taxing state by multiplying the total income of the enterprise by a percentage comprised of the average of the ratios of instate property, payroll and sales to total property, payroll and sales. The precise formula varies from one State to another.

14. The theory underlying this "unitary" approach is that a dollar of payroll or property spent or a dollar of sales made in one tax jurisdiction produces roughly the same amount of taxable income as a dollar so spent or sales made in another tax jurisdiction. This theory manifestly falls down when applied to two (or more) countries whose economic circumstances are very different. For example, in a developing country property and payroll costs may be very low, relative to those in the United States. On the other hand profits will probably be higher to reflect the risks of expropriation, currency exchange limitations, or other factors. Applying the unitary basis to a group operating both in the USA and a developing country will thus result in a reallocation of group's income from the developing country to the USA. Quite apart from the implications for the group itself (which are

discussed in more detail below), it must be open to question whether this represents an equitable division of world resources.

Incompatibility with arm's length basis

15. Second, because international trade relations operate on an entirely different (i.e. arm's length) basis, the worldwide application of the unitary system produces results which are at best anomalous and at worst give rise to serious inequities. In sharp contrast to the unitary method (see above), the arm's length method requires the income of each corporation to be computed on a separate accounting basis under the assumption that each member of a corporate group must deal with the other members as if they were wholly separate entities owned by unrelated interests. This method has now been recommended by both the OECD and UN model treaty and enshrined in a worldwide network of bilateral treaties to prevent double taxation, including those treaties to which the USA is a party. In addition, following the lead given by the US Federal Authorities in 1928, virtually all developed countries have now adopted the arm's length standard for preventing tax avoidance through artificially fixed inter-company prices.

16. The unitary method and the arm's length method are not compatible. Applying the unitary formula to groups which also operate in countries which work on the arm's length basis leads to cases of double taxation. It has been argued that the unitary basis does not in fact tax the foreign source income of foreign corporations related to the "unitary" company. Instead that income is merely taken into account in order to determine the net income attributable to activity within the "unitary" state. But the arithmetical results of applying a unitary formula belie this argument. The "unitary" state is in effect requiring a consolidated income tax return and subjecting to tax the income earned by foreign members of the unitary group without giving any relief for overseas tax. In other words it has extended its jurisdiction to bring into its tax net income over which other states will have exercised their priority taxing rights under the normal arm's length arrangements.

17. The element of double counting this involves can and does lead to multinational groups being taxed on more than 100 per cent of their income. This may represent an additional financial cost for the group itself, which is inequitable. Or it could lead to a diminution of the revenues flowing to any exchequer which seeks to avoid double taxation by giving credit for the "unitary" tax paid — a result which at best can be described as anomalous. These inequities and anomalies are particularly acute in the — not uncommon case — where the US company of a unitary group operates at a loss. Even though it had made no profit by any normal commercial standards, the US company would be liable for tax in respect of a portion of the worldwide profits of its foreign affiliates. In other words there would be an element of direct subsidy from the worldwide group (or foreign revenue as the case may be) to the unitary state.

Unitary basis is not uniform

18. Third the unitary basis is not — and cannot be — uniform in its application. The very concepts it uses are incapable of precise definition, at least on anything other than a very local basis. It is notable that, even amongst the various states within the USA, there are significant variations first in the criteria used for determining whether or not a particular corporation is "unitary", and second in the formula to be applied to unitary corporations. Even within an individual state it is by no means unknown for a business which has been deemed "unitary" one year to be classed as non-unitary the following year, and for the basis of calculating its tax liability to vary from one year to the next. As a result no business can be sure whether or not it will be adjudged to be "unitary" and if so, how its tax bill will be calculated. In other words the unitary basis breeds uncertainty. The problem this creates for business is heightened by the lack of any procedure analogous to that embodied in "arm's length" tax treaties for resolving disputes about the application of the rules to individual cases.

Unitary basis imposes high compliance costs

19. The fourth aspect of the unitary basis which contributes towards its damaging effects is the compliance costs it involves. It is for the companies themselves to tell the Working Group what complying with the unitary system means in practice. The UK Government would merely note that the full requirements of the system necessitate, at a minimum, the translation into US dollars of accounts maintained by related companies in a multitude of different currencies and the preparation of extra sets of accounts to meet the specific, and varying, requirements of the unitary states. And we understand that the details requested often reflect confidential data, trade secrets, or other information that cannot be made available for reasons totally unrelated to tax considerations.

20. Of more direct concern to the UK Government is the extent to which the unitary states' demands for financial information may involve investigation of the records of UK companies which are outside the USA. More often than not, the substantial majority of the records required describe business transactions that are entirely unrelated to activities within the United States. This is objectionable in principle, as well as producing excessive compliance burdens in practice.

Comparison of unitary method with arm's length method

21. By contrast, the arm's length method, though not perfect, avoids these four very real problems which inevitably arise when the unitary basis is applied worldwide. First by focussing on the amount of profit that would have been made within an individual country by independent parties dealing at arm's length, it recognises that companies operating in different economic circumstances will incur different costs and run very different risks. Second, there is of course no question of the basis being incompatible with internationally accepted methods — the arm's length basis *is* the internationally accepted method. Equally, the 'international' nature of the arm's length method helps to avoid the third problem — the lack of any uniform rules. Because it has been for so long the guiding principle of international tax, there has been time to smooth out the 'rough edges' of the arm's length

method. The countries of the world have evolved a series of internationally accepted standards which are capable of exact definition under clearly applied procedures. So the various problems identified earlier — of double taxation: of companies being liable to tax on more than 100 per cent of their income: of companies being liable to tax in respect of profits when, on normal commercial principles, they are making a loss — simply do not arise or where they do, they can be satisfactorily resolved.

22. The fourth problem, that of high compliance costs for companies, equally does not arise to anywhere near the same extent under the arm's length method. The information required in order to operate this method is, more often than not, information which companies have already had to prepare for other purposes. The use of accounts drawn up to comply with company law requirements is a good example of this.

23. Generally, therefore, when measured against the criteria for judging a tax basis the arm's length basis is on each count preferable to the worldwide unitary method. It is at once more equitable, more certain, simpler and more conducive to efficiency. Nor does there seem any good reason why it should not serve as an effective policing mechanism to protect the revenue of individual states. There is an extensive body of Treasury Regulations under Section 482 of the International Revenue Code of 1954 providing definitive guidelines governing the fiscal relationships of commonly-controlled corporations. Moreover we understand that, under long-standing accords, information gathered by the United States Treasury from Federal tax audits is continually made available to the individual States. Against this background, the majority of States have felt able to operate an arm's length system, and to apply this rule to subsidiaries of multinational group resident within their jurisdictions.

Wider consequences of the unitary system

24. Any set of rules which fails to measure up to the criteria of a good tax system must be expected to have adverse consequences which go well beyond the immediate impact of that set of rules itself. This is certainly the case with the current application, by several US States, of the unitary system on a worldwide basis.

25. First there is now evidence that it is inhibiting trade relations and distorting investment patterns. In the light of the inequities, anomalies and uncertainties generated by the tax rules, foreign corporations are re-appraising the benefits and burdens of conducting business within a unitary state. The recent decision by the London Chamber of Commerce to cancel its mission to Florida on account of Florida's adoption of the worldwide unitary basis is a good example of this.

26. Furthermore, the spread of unitary taxation amongst the various States can only serve to undermine the very strong position that the United States has adopted in OECD and elsewhere for the liberalisation of international investment flows. The position was restated only a few weeks ago by President Reagan himself in his 9 September Statement on US policy towards international investment. The continued imposition of unitary taxation is incompatible with this stance.

27. These adverse consequences for worldwide trade and investment would be even worse if other countries respond to the States' application of unitary tax by taking retaliatory measures or introducing unitary systems of their own. In particular the States' operation of the worldwide unitary basis, and the US Federal Government's failure to prohibit this system, may well serve as an example which other countries will soon choose to follow. In particular some developing countries may feel that the system has its attractions for them. If such countries adopt unitary tax, they would be unlikely to follow the three factor formula used, for example, in California. The very different economic conditions which prevail in the developing world would naturally incline them to develop or emphasise factors which allocate a greater proportion of income to the developing country. They might for example focus simply on sales.

28. The effects of other countries taking retaliatory measures, or unitary tax spreading outside the United States, will be keenly felt by the United Kingdom. This is because the UK invests on a substantial scale in foreign countries in both the developed and developing world. But if the UK is a substantial investor in foreign countries, the United States is a much larger one. So the adverse impact on the United States must be expected to be much

greater. As things stand at present the economic burden this imposes will, in large part, fall on the United States Federal Government. Because the United States' Internal Revenue Code allows a credit against United States taxes for taxes paid to a foreign country (subject to certain limitations), any increase in foreign taxes could be offset dollar for dollar by a reduction in United States taxes.

III. CONCLUSION

29. In this paper the UK Government has analysed the worldwide unitary system by reference to the universally-accepted criteria of a good tax system — equity, certainty, simplicity and the promotion of economic efficiency. It has demonstrated that, when applied in the present international context, the worldwide unitary method inevitably produces results which are inequitable and uncertain. The method involves additional compliance costs for companies. Furthermore it is in the United Kingdom Government's view objectionable in principle that the method can require the disclosure of the records of companies outside the USA, particularly as these will often apply to transactions entirely unrelated to activities within the United States.

30. If the worldwide unitary system is allowed to persist it will hamper rather than promote economic efficiency distorting investment patterns and inhibiting trade throughout the world. It makes it impossible to achieve the essential objective of providing a consistent and coherent international tax framework for trade and investment. This framework is particularly crucial at the present juncture in the development of the world economy, when businesses are seeking profits throughout the world without regard to national boundaries. The narrow economic standpoint of the unitary system is incompatible with the harmonious relationship that is the goal of our governments, to the benefit of the American and British people alike.

EXHIBIT 30C

Paper Submitted by the Government of Canada to the United States Treasury Working Group on Unitary Tax

The purpose of this paper is to express the concerns of the Government of Canada about the increasing use within the United States of America of "unitary" methods of taxation on the basis of combined worldwide apportionment. Such methods tax the combined worldwide incomes of a domestic subsidiary and its foreign parent, in conflict with the "arm's length" method used by the United States Government and accepted internationally.

Our concern is based principally on the incompatibility of these two methods of taxation which often results in multiple taxation that cannot be relieved through existing taxation conventions. This unrelieved multiple taxation combined with the administrative burden of complying with unitary tax requirements imposes a continuing obstacle to the flow of international trade and investment.

1. *The Incompatibility of Combined Worldwide Apportionment with Generally Accepted Prnciples [sic] of Arm's Length Income Allocation for Tax Purposes Often Results in Multiple Taxation.*

Under the arm's length approach, broadly speaking, every corporation is subject to tax only by the jurisdictions in which it operates and only on that portion of its business attributable to the business carried on in that jurisdiction. Profits are subsequently taxable when distributed on dividends in those jurisdictions where the dividends are received for tax purposes. Combined worldwide apportionment, in contrast, combines the profits of admittedly related but separate entities and taxes them on the basis of an arbitrary formula that can vary from State to State. Separate entities, dividend flows and sources of profitable activity are ignored under combined worldwide apportionment.

The arm's length approach is clearly the internationally accepted norm for allocating income for tax purposes. This approach is in accordance with the model conventions for the avoidance of doubt taxation developed by the Organization for

Economic Cooperation and Development (OECD)[1] and the United Nations, both of which *expressly rejected formula apportionment* in favor of arm's length allocation.[2] These principles have been adopted by the nations of the world, (including the USA) in their double taxation treaties.[3]

The ramifications of using an incompatible system are significant. Most large multinational enterprises have profitable as well as less profitable (and some unprofitable) activities. Under the arm's length system, the profitable activities are subject to taxes where profits are made, and the less profitable or unprofitable ones pay less or no taxes in the jurisdictions where they are carried on. Combined worldwide apportionment, however, unrealistically implies that individual entities of the multinational enterprise have the same level of profitability. Only in the rare instance where the very different assumptions underlying both systems yield the same result are they consistent with each other. Combined worldwide apportionment methods tax worldwide, pre-tax income calculated on the worldwide basis. These methods override the intent of local tax incentives in third countries, including accelerated depreciation and ignore local tax payments which are often high.

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[1]The Organization for Economic Cooperation and Development was created in December 1960 to promote specified policies. The members of O.E.C.D. are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom and the United States of America.

[2]*See* United Nations Model Double Taxation Convention Between Developed and Developing Countries, arts. 5(8), 7(2), 9(1), U.N. doc, ST/WSA/102 (1980); Report of the OECD Comm. on Fiscal Affairs, Model Double Taxation Convention on Income and on Capital, arts. 5(7), 7(2), 9(1) (1977).

[3]*See, e.g.*, U.S. Treasury Department's Model Income Tax Treaty of June 16, 1981, arts. 5(7), 7(2), 9(1), I CCH Tax Treaties 158.

2. *Multiple Taxation Brought about by the Application of Combined Worldwide Apportionment Methods is Unrelieved by Existing Double Taxation Conventions.*

(a) International Efforts Towards the Elimination of Multiple Taxation

The increasing economic interdependence of western developed nations in the post-war period and the economic co-operation established among them has greatly increased the importance of preventing international multiple taxation. This need was recognised by the OECD which produced a "Draft Double Taxation Convention on Income and Capital" in 1963.

This Draft Convention has had wide repercussions. OECD member countries (including the USA) have largely conformed to it when concluding or revising bilateral double taxation conventions. More than 200 bilateral conventions for the avoidance of double taxation with respect to taxes on income and on capital have been concluded between OECD member countries. As a result, OECD member countries have achieved a considerable degree of harmonization between their bilateral conventions in the benefit of both taxpayers and national administrations and have thereby established a framework for understanding and cooperation on taxation matters which has contributed to the enormous growth of trade and investment since 1945.

Lastly, the impact of the Draft Convention of 1963 and the revised Model Convention approved in 1977 has extended outside the OECD area; it has been used as a basic document of reference in negotiations between member and non-member countries and even between non-member countries, as well as in the work of other worldwide or regional international organizations in the field of double taxation and related problems.

(b) Canada the USA Double Taxation Conventions

Neither Canadian[4] or U.S.[5] Double Taxation Conventions bind the governments of Canadian provinces or U.S. states. However, in Canada, in the case of the provinces with which the Government of Canada has a tax collection agreement, (all provinces except Quebec, plus Alberta and Ontario for corporation tax) the modifications made under bilateral double taxation conventions to the federal tax base on which provncial [sic] income taxes are calculated also apply to provincial income taxes. In addition, it has been the practice that Alberta and Ontario (for corporation tax) and Quebec abide by the rules set out in bilateral double taxation conventions.

By contrast U.S. states using combined worldwide apportionment do not utilize the provisions of existing U.S. double taxation conventions even on a voluntary basis. This is because multiple taxation caused by the application of this method occurs because it uses entirely different principles for deciding where income is earned. The multiple taxation produced can only be resolved if one tax method is required to give way to the other.[6]

Double taxation conventions were thought to be the logical instruments for dealing with the multiple taxation caused by combined worldwide apportionment. Canada attempted to deal with unitary tax practices during the lengthy negotiations which led to the signing of a new Canada-USA Double Taxation Convention in 1980 (not yet in force). Canada was unsuccessful as it was understood that the Senate of the United States had not previously consented to any limitation on the taxing jurisdiction of

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[4]As of November 30, 1983 Canada had 32 Double Taxation Conventions in force, 12 new or revised Conventions signed or about to be signed and another 28 new or revised Conventions under negotiation.

[5]As of January 1, 1983 the USA had Double Taxation Conventions in force with approximately 40 nations.

[6]While it is true that differences n [sic] the allocation of income and expenses among national tax jurisdictions employing the arms length method can also result in multiple taxation or undertaxation, these differences, being those of inconsistent applications of the same principle, can be eliminated and are susceptible to resoluiton [sic] through international negotiation and double taxation conventions.

the states by a treaty and that a provision which would have restricted the use of unitary apportionment in the case of United Kingdom corporations had previously been rejected by the Senate. However, if an acceptable provision on this subject can be devised, the United States has agreed formally to reopen discussion with Canada on this subject.[7]

(c) The Threat Posed by Combined Worldwide Apportionment to International Order in the Field of Taxation

In the opinion of the Government of Canada, the growing incidence of unresolved multiple taxation of foreign based corporations, brought about by the use of combined worldwide apportionment by major jurisdictions with the world's foremost economic power, threatens to undermine the significant progress achieved within the OECD over the last 25 years in harmonizing international taxation practices through the use of double taxation conventions. Moreover, Canada is concerned that the longer this issue remains unresolved, the greater the possibility becomes that certain foreign countries could decide to adopt variations of the unitary assessment method as a means of increasing their tax revenues.

3. *Unitary Tax Places a Significant Extra Administrative Burden on Canadian Multinational Enterprises (MNE's)*

The combined worldwide apportionment method imposes significant administrative burdens on Canadian companies doing business in those States using this method. For a foreign multinational company with subsidiaries in different countries, the submission of financial data for all of these companies to a State of the United States imposes a costly burden.

The additional administrative burden results from the uncertainty as to what foreign corporations should be included in the unitary business group (there is no standard definition), adjusting foreign financial statements to reflect State income tax laws, and

[7]*See* the exchange of letters appended to the Convention between Canada and the United States of America with respect to taxes on Income and on Capital, Washington, September 26, 1980.

translating multiple foreign currency into U.S. dollars. The uncertainty can result in lost revenue, as companies must ensure cash flow is available to cover potential taxes. In addition, substantial interest and legal costs are incurred. The administrative burden is extreme in the case of widespread multinational corporations, because accounting procedures, language and currencies vary significantly from one foreign country to another. Data may have to be obtained from all subsidiaries operating in numerous foreign countries. The information obtained from foreign subsidiaries is often in a foreign language, requiring translation. The foreign company must also perform a "foreign currency translation" with respect to foreign financial data to achieve compatability between U.S. dollars and various foreign currencies, a procedure the Comptroller General has characterized as "a laborious task."[8] As foreign subsidiaries cannot be expected to have the expertise to perform these complicated exercises, specialists have to be hired. While U.S. multinationals are required under U.S. federal law to convert financial data on effectively connected foreign subsidiaries to a U.S. tax base, such a requirement does not otherwise exist for Canadian multinationals under U.S. or Canadian tax laws and thus the extra administrative burden on Canadian multinationals is significant.

The costs of compliance are compounded by the need to prepare separate returns that conform to the varying State tax accounting requirements of the States presently employing some variant of the combined worldwide apportionment scheme. As the Comptroller General has noted, corporate taxpayers must treat the income tax returns for each State separately, and a multijurisdictional taxpayer would have to make "still more calculations for every other area where nonuniformity exists.[9] . . ."

Canadian multinationals have informed the Government of Canada that certain States hold them responsible for all revenues

[8]Report by the Comptroller General to the House Committees on Ways and Means: Key Issues Affecting State Taxation of Multinjurisdictional Corporate Income Need Resolving (GAO/CCD-82-38 (1982) at 39.

[9]*Id.* at 17.

of all foreign affiliates, even those in which they hold only a partial interest. These multinationals have also emphasized that rather than attempting to determine precisely the taxes owing, certain states prefer to negotiate the amount of tax, thus making it very difficult to even determine the precise tax liability according to law.

4. *The Extraterritorial Reach of Unitary Tax Schemes Using Combined Worldwide Apportionment May Give Rise to International Jurisdictional Conflicts.*

Unitary schemes require the local entity of the unitary enterprise to go out of State to obtain financial information held by the foreign parent or subsidiaries in third countries in order to comply with local State requirements. These schemes ignore the fact that even within unitary enterprises certain financial information is confidential, as between parent and a subsidiary and between subsidiaries, especially so when subsidiaries are not wholly owned. The situation is even more difficult when the relevant financial information reflects trade secrets or confidential information relating to the relations between foreign-based corporations and foreign governments. If the local entity is unable to comply (because of foreign law or the unavailability of the required information) the state taxing authority may arbitrarily determine the worldwide tax base and may even exact additional penalties for failure to provide the requested books and records. Such arbitrary practices are likely to evoke responses from foreign jurisdictions. If combined worldwide apportionment continues to spread, the potential for jurisdictional conflicts with foreign jurisdictions will increase proportionately.

5. *Combined Worldwide Apportionment is a Disincentive to International Investment*

Unitary tax schemes using combined worldwide apportionment, in place in fourteen U.S. States, already pose a significant disincentive to foreign direct investment in these States and impede the benefits which such investment can provide in facilitating international trade in goods and services. The possibility that the parent corporation and other subsidiaries may have to channel funds from their non-U.S. operations to pay taxes on

illusory profits created by an application of unitary tax schemes is a factor that any new investor now has to take into account. If more States adopt these unitary methods, the United States as a whole will become a less welcoming environment for investment.

The United States government in its recent international investment policy statement (September 09, 1983,) claims that "the United States has consistently welcomed foreign direct investment in this country. Such investment provides substantial benefits to the United States. Therefore, the United States fosters a domestic economic climate which is conducive to investment". The Canadian government considers that the use of unitary tax schemes is inconsistent with the above-stated U.S. international investment policy goals.

Conclusion

In summary, the inherent incompatibility of combined worldwide apportionment with the international method of income apportionment and the problems involved in its application to foreign-based multinationals serve to undermine the stability of the existing international tax framework and presents a significant obstacle to international trade and investment. The narrow focus of States applying combined worldwide apportionment is incompatible with the leadership role played by the United States of America in the world economy and with the commitment of both our countries to work towards world economic recovery. It is essential that the Working Group consider the threat that combined worldwide apportionment poses to the close economic relations enjoyed by our two countries.

EXHIBIT 30D

AUSTRALIAN SUBMISSION TO U.S. TASK FORCE ON UNITARY TAXATION

The Australian Government is concerned by the application of unitary tax to Australian companies trading in the United States and refers to the Note presented to the State Department on 7 November 1983 (a copy is attached).

The Australian Government has received representations from a number of Australian companies and business organisations regarding the unfair and onerous nature of unitary tax assessments. The views of these companies and organisations have been separately submitted to the Task Force. These representations focus on the effects of unitary tax on individual company operations and general questions of arms' length taxation principles, the administrative and cost burden of unitary assessment and the uncertainty that unitary tax introduces into company investment decisions.

The Australian Government considers that commercial relations between our countries benefit from the establishment of clear and equitable rules for commercial transactions. Under such rules commercial decisions and activities can be conducted within a predictable and stable environment. However, there is evidence that the imposition of unitary taxes by some U.S. States is detracting from this environment.

By taxing the world-wide profits of Australian companies, trading arrangements developed by these companies in the United States are subject to tax liabilities not related to the commercial standing of ventures but rather to business developed in Australia and third countries. Apart from the possibility of double taxation such companies may be disadvantaged in competing with local companies as they are subject to a higher tax burden based on world-wide income. This liability may raise the commercial costs of these companies, thus effectively discriminating against trade arrangements of Australian companies and introducing a serious degree of uncertainty over future commercial operations in the United States.

The imposition of unitary tax is particularly onerous where companies seeking to develop new opportunities in the United States are geared to sustain losses during the establishment phase in order to create a sound business base. Under the unitary method these companies, during an early stage of development, may incur tax liabilities based on the profitability of their often unrelated operations in other countries and States. Any extra burden of taxation makes the development of new opportunities a more hazardous proposition. There is a danger that the climate for investment in the United States could be affected as the threat of unitary tax assessments becomes a reality in more and more States.

The Embassy of Australia avails itself of this opportunity to renew to the Department of State the assurances of its highest consideration.

[Australian Embassy Seal]

WASHINGTON
7 November 1983

Note No: 383/83

The Embassy of Australia presents its compliments to the Department of State and has the honour to refer to the application by some States of the United States of the unitary method of taxation of the foreign income of Australian companies conducting business in the United States.

The Government of Australia sees the application of this method of taxation to the overseas income of Australian companies trading in the United States as incompatible with internationally accepted taxation principles embodied in, for example,

the model double taxation convention endorsed by the OECD in a recommendation which the United States has approved. Moreover, the same principle which the unitary tax offends is found both in the old and new taxation treaties between the Governments of Australia and the United States.

The method of unitary apportionment raises the real likelihood that economic relations between the United States and other countries such as Australia will be hindered. It creates the possibility of double taxation of income derived from Australian sources of Australian companies carrying on business in the United States. Such Australian companies will be placed in an inequitable position. They would also have to undertake onerous administrative tasks to provide the necessary information to State taxation authorities for assessment of tax liability under the world-wide apportionment formula.

As some Australian companies have already been advised they are liable for payment of unitary taxation, the Government of Australia believes the Government of the United States should take action as soon as possible to minimise the serious implications for international economic relations arising from the application of unitary tax to Australian companies. The need for action is more pressing in light of the recent Supreme Court decision in Container Corporation of America versus Californian Franchise Tax Board. In this regard the Government of Australia notes that the Supreme Court decision may lead to movement by more State Governments away from the "arms-length" tax method to the world-wide apportionment formula. It also poses the danger of other countries adopting this method of taxation and thus undermining an accepted international basis of taxation.

The Government of Australia notes the establishment of a working group charged with developing Federal policy on the unitary tax problem.

The government of Australia would appreciate receiving from the Department of State advice on the action of the Government of the United States to resolve the unitary tax problem.

It needs to be recognized that the continued application of unitary tax to income earned internationally by foreign companies

trading in the United States may lead to the introduction of similar taxation in other countries.

The Government of Australia sees the application of this method of taxation to the overseas income of Australian companies trading in the United States as incompatible with internationally accepted taxation principles embodied in, for example, the model double taxation convention endorsed by the OECD in a recommendation which the United States has approved. Moreover, the same principle which the unitary tax offends is found both in the previous and revised taxation treaties between the Governments of Australia and the United States. In this regard, the Government of Australia shares the view expressed by the Government of Japan that the proliferation of unitary tax systems greatly impairs international efforts to prevent international double taxation.

WASHINGTON, D.C.
4 January 1984

EXHIBIT 32B

United States Department of State
Washington, D.C. 20520

July 10, 1985

To Whom It May Concern:

I, Frank M. Machak, state the following:

I am Chief, Information Access and Services Division, Foreign Affairs Information Management Center, and am responsible for the maintenance of the records of the U.S. Department of State.

The attached document hereunto annexed is a true copy of a document retrieved from the files of the Department of State.

I declare, under penalty of perjury, that the foregoing statements are true and correct.

/s/ FRANK M. MACHAK

Frank M. Machak
Chief, Information Access and
Services Division

Attachment:

Official letter with note attached from the Italian Embassy to the Department of State, Washington, D.C., dated March 19, 1980.

AMBASCIATA D'ITALIA
WASHINGTON, D.C.

The Italian Embassy presents its compliments to the Department of State and, on behalf of the Nine EEC Governments, of which the Italian Government has now the presidency, it has the honor to forward the attached Note on the problems of the unitary method of taxation.

The Italian Embassy welcomes the opportunity to renew to the Department of State the assurances of its highest consideration.

Washington, D.C.
March 19, 1980

To the
Department of State
Washington, D.C

UNITARY TAXATION

1. Our Governments are concerned about the application to US subsidiaries of foreign companies of the unitary basis of taxation as applied in California and in varying degrees by certain other States.

2. The unitary basis makes no attempt to examine the profits generated by the subsidiary. It looks to the total profits of the worldwide operations of the group of which the subsidiary is a part, and claims a portion of those profits on the basis of the assumption that certain specified factors, such as the fixed asset values, turn-over and payroll, affect the profits of the subsidiary in the same way and to the same extent as the profits of the group as a whole, irrespective of where the corporations of the group operate. This means that, whenever the group as a whole makes a profit the subsidiary will be taxed on a portion of this profit, even if the subsidiary is actually making a loss, or in the reverse situation, that the subsidiary may not be taxed if the group as a whole has made a loss, although the subsidiary is actually in a profit making position.

3. This method is incompatible with the principles accepted by all OECD member states and recommended to all states as a basis for the taxation of subsidiaries or permanent establishments of foreign enterprises. These principles require that a subsidiary should be taxed only on the profits it actually has made, provided that these are based on dealing at "arm's length" between the subsidiary and related enterprises, i.e. that the transactions between the subsidiary and related corporations are on the same or on a comparable basis as transactions between wholly independent parties. This is intended to arrive at a fair measure of profit and rule out artificial pricing between members of the group for the sole purpose of minimizing tax liability.

4. Unless the same basic rules for calculating taxable profits are followed generally by the main trading nations it will be impossible to achieve the essential objective of providing a consistent and coherent international tax framework for trade and investment.

5. The unitary tax basis can give rise to obviously inequable tax liabilities, and to a form of double taxation which often cannot be relieved, or can be relieved only if countries, which follow generally accepted practices, bear an unfair burden of relief.

6. Unitary taxation, because it requires worldwide reporting of the group's activities in the state where the subsidiary operates imposes very heavy compliance costs, in addition to the costs of compliance and reporting for non-US corporations in their "home countries".

7. The Federal Government uses the arms-length basis for its taxation of subsidiaries of foreign corporations.

8. The problem was addressed in the US/UK Double Taxation Treaty, Article 9 (4) of the Treaty, which was supported by the Administration, would have disallowed the imposition of unitary taxes on subsidiaries of UK companies. When the Senate voted on the Treaty in 1978 the majority approved the Treaty with Article 9 (4) in its original form, although the necessary two-thirds majority was not achieved. Subsequently, the Senate approved the Treaty with the necessary two-thirds majority, but subject to the reservation that Article 9 (4) was not to apply for the purpose of state taxation. Article 9 (4) remained in the Treaty, but only for the purpose of national taxation.

9. There are currently four relevant bills in Congress. S983, S1688, HR 5093 and HR 5076, the last of which is scheduled for hearings on the 31st of March.

In the view of the strong arguments against unitary taxation, our Governments urge you to support this legislation in so far as it relates to the unitary tax issues raised above, with a view to early enactment.

Washington, D.C.
March 19, 1980

EXHIBIT 32C

United States Department of State
Washington, D.C. 20520

July 10, 1985

To Whom It May Concern:

I, Frank M. Machak, state the following:

I am Chief, Information Access and Services Division, Foreign Affairs Information Management Center, and am responsible for the maintenance of the records of the U.S. Department of State.

The attached document hereunto annexed is a true copy of a document retrieved from the files of the Department of State.

I declare, under penalty of perjury, that the foregoing statements are true and correct.

/s/ FRANK M. MACHAK

Frank M. Machak
Chief, Information Access and
Services Division

Attachment:

Note No. 51 from the British Embassy to the Department of State, Washington, D.C., dated March 25, 1980.

1. Her Britannic Majesty's Embassy present their compliments to the Department of State and have the honour to refer to the discussions between representatives of the two Governments about the convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains, signed at London on 31 December 1975, as amended by protocols signed at London on 26 August 1976, 31 March 1977 and 15 March 1979 (hereinafter referred to as "the Convention"). It is a matter of regret to her Majesty's Government that difficulties over one aspect of the Convention, although it is an important one, should have tended to obscure the

achievement of the two Governments in reaching a fair and balanced agreement.

2. Among double taxation treaties, that between the British and United States Governments has a pre-eminent position. The economic and financial links between the two nations are so strong and the areas covered so diverse that, apart from its intrinsic importance to the United Kingdom and the United States of America, the Convention attracts wide interest internationally and is a source of authority in its field.

3. Her Majesty's Government is therefore gravely concerned that as a result of the amendment resulting from the United States Senate reservation on Article 9(4) the Convention does not comprehensively restrict the application of the unitary basis of taxation. That Article in its original form would have prevented the United States Government and the individual States of the United States of America from applying this basis to United Kingdom corporate groups which have subsidiary companies in the United States. In its final form the Article applies only for the purposes of United States federal tax, where the unitary basis is not employed, and does not cover individual States of the Union. This is not only a set-back for British corporate investment in the United States. It may also be interpreted as awarding some approval for the unitary basis of taxation and could have wider repercussions.

4. Her Majesty's Government is convinced that the unitary basis of taxation with combined reporting, particularly as applied in the international field, is entirely unsatisfactory. The Organisation for Economic Co-operation and Development has explored, encouraged and developed the "arms's-length" principle for regulating the taxation of multinational enterprises operating through subsidiary companies or branches. This principle requires that the subsidiary or branch should be taxed only by reference to the profits which its own activities generate. Where these activities involve transactions with related enterprises and these transactions are not on the basis which would be made between wholly independent enterprises, the profits are to be adjusted for tax purposes by reference to the independent enterprise test i.e., the "arms-length" basis. This is intended to achieve a fair measure of

the profit by cancelling the effect of any artificial pricing between related enterprises. The "arms-length" approach has been internationally accepted and is a vital feature of double taxation conventions throughout the world.

5. The unitary basis with combined reporting is a quite different approach. It makes no attempt to examine the profits made by the locally based subsidiary company. It may look to the total profit of the world-wide operations of the group and claim a proportion of that total by reference to arbitrarily defined criteria. The problems associated with this technique are many and have been well rehearsed. The tax consequences are unpredictable and arbitrary. The widely varying commercial and economic climates in different countries produce inequitable results. Under this system it can lead to a demand for tax by reference to group profits earned from unconnected activities to other parts of the world where they are already taxed, even although the local subsidiary is incurring substantial losses. On the unitary basis there is likely to be unrelieved and unrelievable double taxation. In addition the compliance costs are unacceptably high.

6. Apart from these inherent problems associated with the unitary tax basis, its incompatibility with the internationally accepted "arm's-length" basis would generate conflicts between the international investing and trading nations and disruption of international business if the precedent implicit in the Convention were to be followed by other countries. Unless common rules for determining the allocation of profits between different taxing jurisdictions are followed internationally it will be impossible to preserve the essential objective of providing a consistent and coherent international tax framework for business and investment, for which the United States and the United Kingdom have striven together with their fellow members of the Organisation for Economic Co-operation and Development. It is the view of Her Majesty's Government that the unitary basis, which is not a practical international alternative to the "arm's-length" basis, could undo the important and patient international work that has been achieved in regulating international tax practices, and that every effort is required to discourage the use of the extension of that basis. It is to this end that the British and United States

Governments have expressly prohibited its use for the purpose of the respective national tax systems under Article 9(4); and the issue will be an important aspect of the proposed annual review of the Convention.

7. Her Majesty's Government has recognised, in ratifying this Convention with the approval of the United Kingdom Parliament, and in its acceptance of the United States Senate reservation against Article 9(4) of the Convention, the difficult issues raised within the United States in seeking to limit State taxing powers through the double taxation conventions of the United States. It has also recognised the importance of the Convention in its many other aspects for the two Governments and for the business and investment communities on each side. It must be emphasized however that the acceptance of the Senate reservation in no way implies approval of the unitary basis and it is the urgent request of Her Majesty's Government for the reasons given in this Note that the Government of the United States should use its best endeavours to eliminate the international application of the unitary basis of taxation.

8. The British Embassy avail themselves of this opportunity to renew to the Department of State the assurances of their highest consideration.

British Embassy
WASHINGTON

25 March 1980

EXHIBIT 32G

United States Department of State
Washington, D.C. 20520

June 21, 1985

TO WHOM IT MAY CONCERN

I, Frank M. Machak, state the following:

1. I am Chief, Information Access and Services Division, Foreign Affairs Information Management Center and responsible for the maintenance of the records of the U.S. Department of State.

2. The attached document hereunto annexed is a true copy of a document retrieved from the files of the Department of State.

I declare, under penalty of perjury, that the foregoing statements are true and correct.

/s/ FRANK M. MACHAK

Frank M. Machak
Chief, Information Access and
Services Division

Attachment:

Note No. 283 from the Canadian Embassy to the Department of State, Washington, D.C., dated June 14, 1982.

CANADIAN EMBASSY
AMBASSADE DU CANADA

No. 283

The Embassy of Canada presents its compliments to the Department of State and has the honour to refer to its Notes No. 692 and 245 of 22 December, 1981 and 10 May, 1982, together with the exchange of letters between the Secretary of the Treasury for the United States of America and the Canadian Minister of Finance of 26 September, 1980 on the occasion of the signing of the bilateral convention with respect to taxes on income and capital.

The Embassy has been instructed to draw again the attention of United States authorities to Canada's concerns about the unitary tax apportionment method used by certain states in the United States to allocate income to United States offices or subsidiaries of international corporations based on the corporation's worldwide earnings. The Canadian Government continues to be of the view that this method results in inequitable taxation and imposes excessive administrative burdens on international companies doing business in those states. Under this method the profit of a Canadian company, for example, on its United States business is not determined on the basis of arm's-length relations, but is derived from a formula taking account of the income of the Canadian company and its worldwide subsidiaries, as well as the assets, payroll and sales of each of these.

For a multinational company with subsidiaries in different countries to have to submit its books and records for all of these companies to a state of the United States imposes a costly burden.

Against this background the Canadian government welcomed the decision of the Justice Department to file an amicus curae brief before the Supreme Court concerning the appeal of the Chicago Bridge and Iron Company against the use of the unitary tax method applied by the State of Illinois. The Embassy has now noted that another such case will be considered by the Supreme Court later this year involving an appeal by Container Corporation of America versus the Franchise Tax Board (California)

(Case 81-523). The Embassy would wish the foregoing concerns of the Canadian Government to be drawn to the attention of the relevant United States authorities and would welcome these views being referred to in any representation that the United States Administration may be making to the Supreme Court.

The Embassy of Canada avails itself of this opportunity to renew to the Department of State the assurances of its highest consideration.

Washington, June 14, 1982

EXHIBIT 32I

United States Department of State
Washington, D.C. 20520

June 21, 1985

TO WHOM IT MAY CONCERN

I, Frank M. Machak, state the following:

1. I am Chief, Information Access and Services Division, Foreign Affairs Information Management Center and responsible for the maintenance of the records of the U.S. Department of State.

2. The attached document hereunto annexed is a true copy of a document retrieved from the files of the Department of State.

I declare, under penalty of perjury, that the foregoing statements are true and correct.

/s/ FRANK M. MACHAK

Frank M. Machak
Chief, Information Access and
Services Division

Attachment:

Official letter with attached note from the Embassy of Greece to the Department of State, Washington, D.C., dated August 1, 1983.

EMBASSY OF GREECE
WASHINGTON, D.C.

The Embassy of Greece presents its compliments to the Department of State and, on behalf of the Ten European Community Governments, of which the Government of Greece has now the presidency, it has the honor to forward the attached Note on the problems of the unitary method of taxation.

The Embassy of Greece welcomes the opportunity to renew to the Department of State the assurances of its highest consideration.

Washington, D.C., August 1983

Attached: Note

The Department of State
Washington, D.C.

UNITARY TAXATION

I.

Our governments refer to their note on unitary taxation forwarded to the Department of State by the Embassy of Belgium on 29 June 1982.

II.

That note drew the attention of the State Department to the case before the Supreme Court of the Container Corporation of America versus the California Franchise Tax Board and urged as a matter of high priority that the government of the United States should participate in that case as amicus curiae. The decision was handed down by the court on 27 June, 1983, and the court found that application of the unitary business principle by the State of California to Container Corporation and its foreign subsidiaries was proper. A majority of justices held that that fact that no brief had been submitted on behalf of the United States government meant there was no indication that the position taken by the government in the case of the Chicago Bridge and Iron Company still represented its views or that the brief in the Chicago Bridge case applied to the Container case.

III.

Although the Supreme Court decision did not apply to US companies with foreign parents, our governments were disappointed by the Container decision. They remain convinced that the unitary basis of taxation with combined reporting, particularly as applied in the international field, is unsatisfactory. Our governments therefore urge that the United States government should give strong support to legislation to ensure that States do not use that method of taxation at least for the subsidiaries of foreign corporations. There are currently two relevant bills in Congress, HR 2918 and S.1225.

IV.

It is particularly important that federal legislation should be adopted at an early stage since there are already signs that, following the decision in the Container case, other American States not at present using this method are contemplating adopting worldwide combined reporting.

EXHIBIT 32L

United States Department of State
Washington, D.C. 20520

June 21, 1985

TO WHOM IT MAY CONCERN

I, Frank M. Machak, state the following:

1. I am Chief, Information Access and Services Division, Foreign Affairs Information Management Center and responsible for the maintenance of the records of the U.S. Department of State.

2. The attached document hereunto annexed is a true copy of a document retrieved from the files of the Department of State.

I declare, under penalty of perjury, that the foregoing statements are true and correct.

/s/ FRANK M. MACHAK

Frank M. Machak
Chief, Information Access and
Services Division

Attachment:

Note No. 461.20-LJ/hu from the Embassy of Switzerland to the Department of State, Washington, D.C., dated November 15, 1983.

EMBASSY OF SWITZERLAND

461.20 - LJ/hu

The Embassy of Switzerland presents its compliments to the Department of State and has the honor to draw its attention to the following.

At its first meeting on November 2, 1983 the Working Group on Worldwide Unitary Taxation set up a Task Force which will hold hearings on November 16 and 17, 1983. The Embassy of Switzerland has kindly been invited to make its views known to the Task Force.

In a note dated March 16, 1983 the Swiss Embassy has already drawn the Department of State's attention to the serious concerns of the Swiss Government with regard to the unitary method of taxation. It welcomes the opportunity to explain once again the reasons of its position and kindly asks the Department of State to convey the content of this note to the Task Force.

The method of unitary taxation used by certain states of the United States allocates income of Swiss-owned companies with no United States contacts to subsidiaries of such Swiss-owned companies operating in the United States.

The Department of State
Washington, D.C.

This method thereby can produce inequitable results often including double or arbitrary taxation, and imposes expensive administrative and compliance burdens.

The unitary method of taxation lumps together all the worldwide income of a related group of corporations, whether that income was derived from the taxing state or not, so long as the group is engaged in a "unitary" business. The concept of what constitutes a unitary business is often liberally construed by the taxing jurisdiction, and in some instances is interpreted so broadly that it imposes no restrictions on the state's power to tax related corporations.

Furthermore, a formula based on sales, payroll, and assets is applied to that worldwide income to determine the income attributable to the taxing jurisdiction. However, the formula necessarily produces skewed results in the international setting because it assumes that the factors in the formula affect the profits of the subsidiary with U.S. operations in the same way and to the same extent as they do the profits of the related foreign companies. In fact, though, wages, real property costs, and depreciation allowances vary so widely from country to country that sales, payroll and assets often fail to bear the same relation to income in one country as in others.

Finally, the taxing state's income tax rate is applied to the "income" base computed by the steps described above. As a result a taxpayer may actually be liable for taxes for a year in which it has had losses in the taxing jurisdiction.

There can be no doubt that the unitary tax method is incompatible with the internationally accepted arm's length principle. Indeed, it has been argued in a number of recent U.S. Supreme Court cases that it is violative of international law. Under internationally accepted principles, each company is treated as a separate entity. A nation or a political subdivision of a nation (for example, a state of the United States or a Swiss canton) may tax all the income of any resident company, but may only tax nonresident companies on income arising within its jurisdiction. The taxing jurisdiction then uses the "arm's-length" method to ensure that no improper income-shifting occurs. Tax authorities may

recharacterize transactions between or among related companies so as to achieve an "arm's-length" result, thereby recapturing for the income base within the jurisdiction improperly shifted profits. This system has operated effectively to arrive at fair profit allocations and to prevent artificial income-shifting intended to reduce tax liability.

Furthermore, taxation under the unitary method imposes severe compliance costs on foreign parent companies. Such parent companies must submit their books and records for all of their worldwide related companies to each state of the United States that employs the method. They must consolidate their worldwide accounts according to the specific and different requirements of each such state, and convert numerous foreign currencies into U.S. Dollars. Swiss parent companies must convert the results of worldwide operations into Swiss Francs and then reconvert them into U.S. Dollars for unitary tax purposes. In the case of such foreign parent companies in non-English-speaking countries, there are significant translation costs. These compliance burdens are especially serious for many Swiss-based multinational enterprises because of their extensive worldwide operations.

Monetary exchange problems distort true economic income. As noted, for purposes of reporting in each unitary tax state, a Swiss parent company must convert the income of each related company from the currencies of the various countries in which those profits were earned into Dollars at the time each state requires a unitary tax report, even though the expression in Dollars of the results of operations may bear little relationship to economic reality. Fluctuations in the value of the Dollar may increase (or decrease) unitary income in a manner which does not reflect real economic income. These problems are much greater for foreign-based multinationals than for companies based in the United States since the latter maintain their consolidated financial reports in U.S. Dollars.

The application of the unitary tax method to foreign parent companies by certain states of the United States stands as a significant nontariff barrier to trade. Like most such barriers, the unitary method adversely affects the nation in which it is imposed as well as the target nations. The method can chill international

investment and decrease efficient allocation of resources and employment opportunities.

In particular, the unitary method can impede foreign entry into the United States market. During the start-up period of investment in a foreign nation or in a new state, costs tend to be high and profits low, yet, under the unitary method, a tax may be imposed because of the operations of related companies outside the state, even though the newly-created company is clearly operating at a tax and economic loss.

Still another danger of the unitary method to both the United States and its trading partners is the possibility of its spreading by example to nations that do not now use it, especially developing countries. The burden on international trade could become unbearable, as multiple taxation of corporate income and compliance burdens increase out of countrol. The Council of the Organisation for Economic Co-operation and Development (OECD) highlighted that threat in its recent report on transfer pricing, which denounced the unitary method.

The Embassy of Switzerland avails itself of this opportunity to renew to the Department of State the assurances of its highest consideration.

Washington, D.C.
November 15, 1983

EXHIBIT 32M

United States Department of State
Washington, D.C. 20520

June 21, 1985

TO WHOM IT MAY CONCERN

I, Frank M. Machak, state the following:

1. I am Chief, Information Access and Services Division, Foreign Affairs Information Management Center and responsible for the maintenance of the records of the U.S. Department of State.

2. The attached document hereunto annexed is a true copy of a document retrieved from the files of the Department of State.

I declare, under penalty of perjury, that the foregoing statements are true and correct.

/s/ FRANK M. MACHAK

Frank M. Machak
Chief, Information Access and
Services Division

Attachment:

Official letter forwarding attached note from the Embassy of the Federal Republic of Germany to the Department of State, Washington, D.C., dated November 28, 1983.

The Embassy of the Federal Republic of Germany presents its compliments to the Department of State and, on behalf of the Government of the Federal Republic of Germany, has the honor to forward the attached note on the problems of the unitary method of taxation. This note is delivered simultaneously to the Department of the Treasury for attention of the Presidential Working Group on worldwide unitary taxation.

The Government of the Federal Republic of Germany is deeply concerned about the application of the unitary basis of taxation by several states to US subsidiaries of foreign companies. This method is incompatible with worldwide agreed principles on international taxation. Applying the unitary method approach, the federal states have discontinued to adhere to an internationally accepted consensus based on the arm's-length principle of taxation.

A satisfactory solution to the problem is crucial to any improvement in the tax relationship between the Federal Republic of Germany and the United States of America and specifically for an eventual revision of the Agreement for the Avoidance of Double Taxation with respect to Taxes on Income.

In view of the strong arguments against unitary taxation the Federal Government therefore urges the United States Government to give strong support to pending legislation aiming at abandoning the unitary method of taxation at least for the subsidiaries of foreign companies.

The Embassy of the Federal Republic of Germany welcomes the opportunity to renew to the Department of State the assurances of its highest consideration.

Washington, D.C.
November 28, 1983

Embassy of the
Federal Republic of Germany

November 28, 1983

Washington, D.C.

MEMORANDUM TO THE UNITED STATES DEPARTMENT OF THE TREASURY

on the issue of State taxation by worldwide combination and formula apportionment ("unitary taxation")

The Government of the Federal Republic of Germany is deeply concerned about an increasing international incidence of State taxation in the United States of America with respect to German-based multijurisdictional enterprises. It is the intention of the following memorandum to bring the position of the Federal Government to the attention of the Department of the Treasury so it may take into consideration when reviewing the unitary tax issue within the Working Group appointed by the President of the United States.

1. *Unrelieved double taxation*

When a worldwide combination of business income along with formula apportionment is used to calculate a share in unitary group income as a State's tax base, this will invariably attract income or loss elements which were not generated by the State-based entity itself to the State availing itself of such a taxation method. Whether the application of this method results in an advantage or disadvantage for the State, and the multijurisdictional enterprise respectively, depends on the individual case. The best evidence for unitary taxation working either way is the case history available of enterprises litigating both against and in favor of its application before United States courts. Empirical data on the aggregate results of unitary taxation and on the differences in tax costs vis-à-vis arm's length results is just as difficult to collect as it is burdensome to comply with unitary tax rules. These uncertainties inherent to the unitary approach are compounded by the concern that the uncoordinated, simultaneous application of unitary and arm's length concepts internationally will lead to tax

claims of the fiscs involved which, in aggregate, do not reflect economic reality. In contrast to a water's edge approach of combination and apportionment, which would appear to constitute a fair compromise between the need for State revenue and administrative simplicity, unitary approaches, when applied in an economically inhomogeneous international environment, result in a serious misallocation of income. If a United States entity of a German group bears increased costs or experiences a temporarily unprofitable situation, e.g. in start-up or expansionary phases or under other special circumstances of competition, an overassessment in the unitary State (and international double taxation) will be the result because a fair corollary for the partial taxation of foreign income of other — more profitable — group members in the form of a foreign tax credit is not granted.

2. *Compliance cost*

While the evaluation of the actual overall revenue implications of unitary taxation involves considerable judgment at this stage and warrants further exploration, the compliance cost and the administrative burdens engendered by unitary tax statutes are manifest. Not only will a German multijurisdictional enterprise have to consolidate the accounts of the unitary business entities worldwide — a task which is presently otherwise not required for tax purposes under German or United States federal laws and which is particularly painstaking as the delineation of a unitary business neither follows uniform rules under the various State statutes nor always coincides with corporate structures under commercial law. The enterprise will furthermore have to recalculate the combined reports on a dollar basis and adjust its balance sheet items to accommodate differential State accounting and valuation provisions. These administrative burdens are compounded by the high cost of having foreign accounts certified and the cost of special computations required to determine the various factors used in the apportionment calculation. On the other hand, the verification and examination of the various books and records necessary to ensure full compliance with unitary statutes is well in excess of what would appear to be feasible for a State administration whose aim it is to use its resources in a more productive way than under an arm's length concept. The Government of the

Federal Republic of Germany therefore is convinced that, due to these constraints, the administration of unitary tax schemes has to settle for a low degree of precision. It may often have to take recourse to rough estimates and this may even become the normal procedure in the majority of cases. Furthermore, the multijurisdictional enterprise, with respect to compliance cost, is at a disadvantage when compared with a United States based multijurisdictional group which has no part of its unitary business abroad or whose compliance on a dollar basis will be less burdensome.

3. *Direct investment hampered*

The Federal Government emphasizes the fact that German enterprises which have to face the likelihood of double taxation and the compliance cost caused by unitary taxation will have to take their business and investment decisions with a view to the rather mixed tax environment created in the United States by the various forms of State taxation. Tax-induced misallocation of resources both within the United States and internationally is unavoidable if no satisfactory solutions to these impediments can be found. Capital and trade flows between our two countries will be distorted and, to a certain extent, possibly disrupted if the competitive disadvantage of "being multinational" as opposed to "just domestic" is exacerbated instead of reduced by the introduction of unitary statutes by more State legislatures, and a failure to eliminate their negative international impact in those States where they already exist.

4. *Setback for international consensus*

In the past, the free flow of investment capital and trade between the United States and the Federal Republic of Germany has been imbedded in a bilateral tax environment which cannot be viewed in isolation of international developments. The international community has endeavored for decades to create an international tax system that avoids barriers and distortions and gives adequate protection to international trade and investment. In multilateral discussions first initiated by the League of Nations a consensus has emerged — among developing as well as industrialized countries — in favor of the arm's length principle of taxation.

The Federal Republic of Germany and the United States have contributed actively to these endeavors. The unitary approach to taxation of foreign-based enterprises runs counter to this consensus and may be the beginning of its disruption. A failure to bring this development to a halt and to eliminate the international incidence of unitary taxation might lead the international community to conclude that the United States has ceased to speak with one voice and thus is no longer contributing to the international tax order toward which the United States, the Federal Republic of Germany and other nations have worked for so many years. Other countries may follow the practice of unitary States taxation — and there are signs that some of them have already taken steps to safeguard such moves bilaterally — if the conflict with the developed international consensus is not resolved soon. Such a danger of disruption of the international consensus through inaction is a matter of great concern to the Federal Government, irrespective of whether the negative impact falls immediately on German-based investors in the United States or on United States investors in Germany.

5. *Treaty implications*

In a bilateral context, a unitary approach which stops at water's edge and which limits the aggregate of apportioned tax bases to the total domestic tax base cannot be reason for concern. It constitutes a mere proxy for revenue sharing between various national and sub-national jurisdictions. This understanding is reflected in the U.S. — German Tax Treaty to the extent that it grants protection for German Trade Tax, a tax based on a unitary approach limited to domestic income apportionment. The foundation for the present understanding, however, is upset where unitary schemes are implemented across national frontiers. The German enterprises, faced with the incidence of such practices, have every right to be concerned and to solicit protection against such imbalances. In the absense of internal legislation by the United States Congress, the only means to provide protection would appear to be the Tax Treaty itself. The Federal Government therefore feels that the problem of establishing a balanced treaty framework which appropriately addresses the unitary issue needs to be considered. The Federal Government cannot totally

exclude that the different treatment of the German Trade Tax and unitary State taxes under the present treaty will prove to be counterproductive to a speedy conclusion of the ongoing Treaty renegotiations if the international implications of unitary State taxes continue to exist in the future.

EXHIBIT 32P

United States Department of State
Washington, D.C. 20520

June 21, 1985

TO WHOM IT MAY CONCERN

I, Frank M. Machak, state the following:

1. I am Chief, Information Access and Services Division, Foreign Affairs Information Management Center and responsible for the maintenance of the records of the U.S. Department of State.

2. The attached document hereunto annexed is a true copy of a document retrieved from the files of the Department of State.

I declare, under penalty of perjury, that the foregoing statements are true and correct.

/s/ FRANK M. MACHAK

Frank M. Machak
Chief, Information Access and
Services Division

Attachment:

Note from the Embassy of Belgium to the Department of State, dated January 25, 1984, attaching Memorandum of the Government of Belgium on Worldwide Unitary Taxation.

The Embassy of Belgium presents its compliments to the Department of State and, on behalf of the Belgian government, has the honor to forward the attached memorandum on the problems of the worldwide unitary taxation. This memorandum is also being sent to the Department of the Treasury to the attention of the presidential working group on worldwide unitary taxation.

The system of unitary taxation leads to double taxation and also imposes heavy and costly administrative burdens on the corporations involved. The extension of this system to additional States would aggravate the harm already done to the harmonious development of international economic relations. The Belgian government therefore holds the view that it is essential that measures be taken to bring the States to repeal the system of unitary taxation.

The Embassy of Belgium welcomes the opportunity to renew to the Department of State the assurances of its highest consideration.

Washington D.C.
January 25, 1984

Attached: Memorandum.

The Department of State
Washington D.C.

MEMORANDUM OF THE GOVERNMENT OF BELGIUM ON WORLDWIDE UNITARY TAXATION.

The system of unitary taxation, which is at present used by a growing number of States in the United States with respect to taxation of corporate income, has been opposed for many years not only by corporations subject to this taxation system but also by foreign countries, inter alia by European countries.

On several occasions the Member States of the European Community — including Belgium — have conveyed to the Department of State the concern of their business community regarding the system of unitary taxation. They expressed the wish that the U.S. government should take measures aimed at repealing this taxation system.

The Belgian government wishes to bring once again to the attention of the working group, established to examine the effects of unitary taxation, its firm attachment to the universally accepted rules governing the taxation of corporations operating in several countries, and which are included in the OECD Model Taxation Convention of 1977. It expresses therefore its resolute opposition to the system of unitary taxation presently used by a large number of States in the United States.

The Belgian government bases its opposition to this system mainly on the following grounds:

- In the present international context unitary taxation leads to double taxation of corporate income, through the conflict the unitary system generates with conventional methods of income determination, used by all other countries including the United States at the federal level;
- Unlike the principle of independent enterprise, the principle of unitary taxation does not necessarily imply the use of uniform implementation rules. It thus cannot be considered as a principle allowing systematic avoidance of double taxation, quite to the contrary;
- The unitary approach imposes heavy and costly administrative burdens on the corporations involved;

- The extension of this system to additional States would aggravate the harm already done to the harmonious development of international economic relations.

1. *DOUBLE TAXATION.*

The various international organizations, which, for more than half a century, have tackled the problems caused by international double taxation, have always been striving for the greatest possible uniformity in the principles used to define the conditions and the scope of taxability. With respect to the taxation of subsidiaries and branches of foreign corporations, the fundamental principle chosen and since then universally applied is that only the income *effectively* earned by these subsidiaries and branches can be taxable and this of course to the extent that the transactions with other entities of the group took place under conditions of free competition ("arm's length").

This fundamental principle implies, on the one hand, that only income which is the direct result of the activities of the subsidiaries and branches themselves can be taxable; it implies, on the other hand, that the amount of taxable income must normally be determined on the basis of real data, as they appear in the accountancy, if necessary corrected, of the aforementioned subsidiaries and branches.

The choice of this method for establishing taxable income has been guided by the will to confer to the taxation of subsidiaries and branches a strictly territorial scope i.e. not extending beyond the borders of the countries involved. The above mentioned system of determination of taxable income is nowadays admitted in all countries. Furthermore, the experience gained led to rules allowing the implementation of this system in a way effectively avoiding problems of double taxation.

In such a context, use of the system of unitary taxation creates a situation in which double taxation becomes unavoidable, since this system usually leads to a higher level of taxable income than would be obtained by applying the principle of independent enterprise.

One must point out in this connection that the use of the unitary approach essentially aims at increasing the fiscal revenues of the States.

2. *NO UNIFORM IMPLEMENTATION RULES.*

The Belgian government remarks that the principle underlying the method of unitary taxation — i.e. each entity of the group participates in the prosperity of the whole — does not imply, unlike the principle of independent enterprise, that all the States which apply this method have to use rules of determination of taxable income that are at the same time *accurate* and *uniform*.

One notices, in this respect, that the States in the U.S. select criteria of apportionment which are favorable to them. These criteria however do not bind other States. Indeed, these other States can choose other criteria capable of providing them also with increased revenues.

In the same way, the amount of *worldwide* profit of the corporation is determined by specific rules of each State. This amount can therefore vary from State to State.

Double taxation can clearly not be avoided in a situation where variable criteria are applied to a variable amount of profits.

3. *ADMINISTRATIVE BURDEN.*

In order to permit determination of the worldwide profit to be divided between the various subsidiaries and branches involved, these subsidiaries and branches have to communicate the accounting statements of each entity (foreign or not), member of the group. These statements must conform to the accounting standards used in the State where the subsidiary or the branch is located. Furthermore, these statements must be presented in U.S. dollars.

These requirements imply a marked and costly increase of administrative burden for the groups involved. This stems above all from the disparity of the accounting standards used by the different entities of aforementioned groups and also from the fact that the accounting periods of the same entities might not

correspond with the fiscal year of the State where the subsidiary or the branch is located.

The administrative burdens of the foreign groups are necessarily heavier and costlier than those of groups operating only in the United States. Moreover, as a matter of principle, it is questionable to request from a legally autonomous subsidiary the accounts of a foreign corporation.

4. *Damage to International economic Relations.*

It is useful to point out that other American States or other countries could follow suit and adopt the unitary approach, either to misappropriate higher revenues or — this in the case of other countries — as a retaliatory measure.

The extension of the use of this taxation system would further increase the damage to international economic relations. It would hurt in particular countries which as Belgium take an active part in the development of international trade.

The Belgian government's viewpoint is that it is essential that measures be taken to bring the States to repeal the system of unitary taxation. At the very least, using this system should be strictly limited to exceptional cases and subject to the condition that the results thus produced would not diverge appreciably from those obtained through the use of the principle of independent enterprise.

Finally, in order to facilitate for the States in the U.S. the implementation of the universally recognized principle, that only the income effectively earned by subsidiaries and branches can be taxable (with due regard for the arm's length rule), the Belgian government would be prepared to add in the double taxation Convention being negotiated between Belgium and the United States, provisions allowing for the communication to these States of information which will be exchanged under the terms defined by said Convention.

Washington D.C., January 25, 1984.

EXHIBIT 32W

Washington, D.C. March 18, 1985

EMBASSY OF SWEDEN
THE AMBASSADOR

The Honorable
George A. Sinner
Governor of North Dakota
State Capitol
Bismarck, North Dakota 58505

Dear Governor Sinner:

Attached is an informal note on the issue of unitary taxation that is now under consideration in the North Dakota legislature. The text of the note has been agreed upon by the Governments listed, and by the Commission of the European Communities.

I have sent copies of this message to Secretary Baker, the Department of the Treasury, Under Secretary of State Allen Wallis, the Department of State, Mr. Kent Conrad (State Tax Commissioner), Senator David E. Nething (Sponsor) and Representative Alvin Hansauer (Chairman of the House Finance and Taxation Committee).

Sincerely,

W. Wachtmeister

UNITARY TAXATION IN NORTH DAKOTA

The Governments listed below and the EC Commission are opposed to the application of the unitary method of taxation on a worldwide reporting basis because they do not regard it as a viable alternative to the separate accounting method.

Worldwide unitary taxation is not compatible with well established international principles of taxation, and imposes unreasonable tax and administrative burdens on multinational corporate groups doing business throughout the world. It is damaging to commercial and economic relations between the US and our countries. If it continues, the damage to international trading relations will become more serious and investment in North Dakota will become less attractive than in other States that do not apply this form of taxation.

Our Governments welcome the serious consideration being given in North Dakota to proposals for confining unitary taxation to the "water's edge". But they believe that it is very important that the "water's edge" should be clearly defined so as to provide an internationally acceptable basis for determining the profits of overseas companies and overseas groups properly allocable to North Dakota. In particular they believe that all proposals for 'thresholds' should be removed for foreign companies and their activities within the United States taxed as if they were the activities of an independent company: the 90 per cent criterion for qualification as a tax haven should be substantially lowered: all companies, whatever the nature of their business, should be eligible for "water's edge" treatment: and this should not be subject to withdrawal by the State without the taxpayer's agreement. Also the compliance burden should be minimised. We trust that before the legislation is enacted SB 2343 will be amended to make it consistent with the above objectives.

/Australia

Australia
Austria
Belgium
Canada

Denmark
Finland
France
The Federal Republic of Germany
Greece
Ireland
Italy
Japan
Luxembourg
The Netherlands
Norway
Sweden
Switzerland
The United Kingdom
The Commission of the European Communities

EXHIBIT 32CC

TEXT OF LETTER FROM THE UNITED KINGDOM CHANCELLOR OF THE EXCHEQUER TO THE SECRETARY OF THE UNITED STATES TREASURY DATED 20 JUNE 1985

UNITARY TAXATION

I AM SORRY NOT TO HAVE BEEN ABLE TO SEE OR SPEAK TO YOU MYSELF, BUT I HAVE ASKED GEOFFREY LITTLER TO GIVE YOU THIS LETTER AND EXPLAIN WHY WE ARE COMPELLED TO TAKE ACTION HERE OVER UNITARY TAX.

WHEN WE TALKED OVER THE SUBJECT IN WASHINGTON ON 19 APRIL I TOLD YOU OF THE PRESSURE IN OUR PARLIAMENT FOR RETALIATION AND THE PROBABILITY THAT IT WOULD BECOME VERY STRONG IN THE EARLY SUMMER IF SUFFICIENT PROGRESS HAD NOT BY THEN BEEN MADE TOWARDS REFORM IN THE U S, ESPECIALLY IN CALIFORNIA. I EXPLAINED THEN THAT OUR PARLIAMENTARY TIMETABLE HERE COULD WELL REQUIRE ME TO MAKE AN EARLY DECISION ON WHETHER TO ALLOW RETALIATORY LEGISLATION TO PROCEED. OUR 1985 FINANCE BILL, WHICH COVERS TAX LEGISLATION, IS NOW WELL ADVANCED, AND I COULD NOT HOLD UP CONSIDERATION OF UNITARY TAX ANY LONGER.

I HAVE DECIDED THAT, IN VIEW OF THE DISAPPOINTING PROGRESS TOWARDS A SOLUTION — PARTICULARLY IN CALIFORNIA — THE GOVERNMENT CAN NO LONGER STAND IN THE WAY OF LEGISLATION IN THE HOUSE OF COMMONS. THIS WOULD, IF PASSED, PROVIDE US WITH DISCRETIONARY RESERVE POWERS THAT COULD BE IMPLEMENTED IF THE PROBLEM REMAINS UNRESOLVED.

IT GOES WITHOUT SAYING THAT I HOPE THAT THESE POWERS NEED NEVER BE INVOKED. I TRUST CONTINUED PRESSURE FROM THE FEDERAL ADMINISTRATION WILL ENCOURAGE CALIFORNIA AND OTHER STATES TO FIND SOON AN ACCEPTABLE SOLUTION OR — FAILING THIS — THAT THE ADMINISTRATION WILL SECURE THIS BY FEDERAL ACTION.

I THOUGHT YOU SHOULD KNOW OF THIS BEFORE WE MAKE A PUBLIC ANNOUNCEMENT TOMORROW.

EXHIBIT 32DD

MEMORANDUM

From: The Netherlands Government
To: The Governor of California

The Netherlands Government has serious objections to the phenomenon of world-wide unitary taxation. It has expressed these objections on numerous occasions. These objections may be summarized as follows:

— unitary taxation greatly enhances the risk of international double taxation;

— unitary taxation produces unfair and inequitable results;

— unitary taxation imposes disproportionately heavy administrative burdens on non-U.S. based enterprises.

The Netherlands Government has noted with satisfaction that throughout the United States there is a strong tendency towards complete abolition of world-wide unitary taxation, or at least a move to adopt the water's edge principle. It has noted also with great interest that the California Legislature is considering limiting unitary taxation to the water's edge.

With regard to the position of the Netherlands Government on this important issue attention should be given to the following facts: The countries of Western Europe together provide for three quarters of total direct investment in the United States, totalling at the end of 1983 more than $90 billion. Official United States statistics show that direct investment in the United States from the Netherlands by the end of 1983 was approximately $29 billion. The Netherlands is thus the second largest single direct investor with investments nearly equalling that of the number one foreign direct investor, namely the United Kingdom with $32.5 billion. The increase in direct investment from Western Europe in 1983 amounted to $10 billion, nearly equal to Japan's total direct investment in the United States of $11 billion. The Netherlands imports the United States amount to approximately $5 billion, while exports to the United States are close to $3 billion. Despite the dollar exchange rate which heavily favors

exports from the Netherlands, there is still a trade deficit of $2 billion.

Trade between the Netherlands and California heavily favors California. The state exports two to three times more to the Netherlands than it imports.

Finally, the Netherlands firmly believes that international economic growth and well-being is dependent upon free trade and freedom of investment. The Netherlands has always defended these freedoms. The Government of the Netherlands, therefore, strongly urges the State of California to end world-wide unitary taxation.

EXHIBIT 32EE

PRIME MINISTER • PREMIER MINISTRE

OTTAWA, KLA OA2
September 24, 1983

Dear Ron,

I am writing to you to express the Canadian government's serious concern about the unitary tax issue which I understand you are now considering.

This method of taxation which permits individual state governments to levy taxes against the world-wide earnings of multinational corporations is, in our view, undesirable. In many cases, it places international enterprises in the position of having to pay tax in one jurisdiction for profits earned (and taxed) elsewhere.

The recent Supreme Court decision in the case of *Container Corporation vs the California State Franchise Tax Board* has considerably heightened the Canadian government's concerns. In addition to the serious potential for double taxation and the increased administrative costs for business, there is the danger that other states and countries, more occupied with a need for increased tax revenues than with consistent tax standards, may adopt this method.

The Honourable Ronald Reagan
President of the United States of America
The White House
Washington, D.C.

EXHIBIT 32GG

APPENDIX

Embassy of Japan
Washington

August 11, 1983

AIDE-MEMOIRE

Re: The Unitary Tax System

The Government of Japan wishes to present to the U.S. Government agencies concerned the following views with regard to the Unitary Tax System.

The Unitary Tax System, which has been introduced in California and many other states of the U.S., has put a serious burden and constraint on the management and business activities of Japanese-affiliated companies operating in the U.S. We regard the Unitary Tax System as having the following problems:

— It has been causing international double taxation.

— It requires financial and other documents from the companies concerned, which include not only those of the parent company, but of other affiliated companies all over the world, and thus has imposed a tremendous burden on them.

— It has a discouraging effect on Japanese investment in the U.S., and hampers the sincere efforts by the U.S. and Japanese Governments to actively promote Japan-U.S. investment.

Based on this recognition, the Japanese Government has taken every opportunity to raise this question in such fora as the Japan-U.S. sub-cabinet level meeting and Japan-U.S. Trade Subcommittee, and requested the U.S. Government to take appropriate measures as soon as possible to abolish the Unitary Tax System.

On June 27th, the U.S. Supreme Court decided in the Container Corp. of America *vs* Franchise Tax Board Case, that

the Unitary Tax System based upon the world-wide profits of the company concerned, including those of the overseas affiliated companies, is constitutional. Although the Court decision was not on a case in which the head office is located abroad, we are concerned that the decision would encourage a number of states to newly introduce the Unitary Tax System or discourage the states which already have the System from abolishing it. We wish to reiterate that Unitary Taxation can be a barrier to the expansion and development of Japan-U.S. economic relations, including the promotion of our direct investment.

The Government of Japan, attaching great importance to the U.S. Supreme Court decision of June 27th, again expressed concern over this matter in the Japan-U.S. Trade Subcommittee meeting held this July at Wye Plantation, Maryland. We were encouraged to hear the U.S. government explain that it is ready to present an amicus curiae brief in cases where diplomatic implication is involved. The Government of Japan strongly wishes that the U.S. Government will support the motion for rehearing, present the amicus curiae brief in connection with the rehearing of this case, and also take the same appropriate measures in connection with other individual cases. The Government of Japan further requests that the U.S. Government take concrete measures as soon as possible, including possible legislative actions, which will lead to the abolition of the Unitary Tax System.

EXHIBIT 32JJ

AMBASSADE DU GRAND-DUCHE
DE LUXEMBOURG
2200 MASSACHUSETTS AVENUE, N.W.
WASHINGTON, D.C. 20008
(202) 265-4171

30 August 1985

Dear Secretary Shultz,

Referring to our note verbale of August 8, we have the honor to convey to you the enclosed note verbale on unitary taxation on behalf of the Governments of the Member States of the European Communities and the Commission of the European Communities.

This note is submitted in response to the Treasury Department's request for comments on the draft legislation concerning unitary taxation that it had proposed on July 8.

We avail ourselves of the opportunity to renew to you the assurances of our highest consideration.

Sincerely,

PAUL PETERS
Paul Peters
Ambassador of Luxembourg

ROY DENMAN
Roy Denman
Head of Delegation
Commission of the European Communities

The Honorable
George P. Shultz
Secretary
U.S. Department of State
Washington, D.C. 20520

AMBASSADE DU GRAND-DUCHE
DE LUXEMBOURG
2200 MASSACHUSETTS AVENUE, N.W.
WASHINGTON, D.C. 20008
(202) 265-4171

30 August 1985

Dear Secretary Baker,

We have the honor to convey to you a note verbale on unitary taxation on behalf of the Governments of the Member States of the European Communities and the Commission of the European Communities.

This note is submitted in response to your request for comments on the draft legislation concerning unitary taxation that was proposed on July 8.

Sincerely,

PAUL PETERS
Paul Peters
Ambassador of Luxembourg

ROY DENMAN
Roy Denman
Head of Delegation
Commission of the European Communities

The Honorable
James A. Baker III
U.S. Department of the Treasury
Washington, D.C. 20220

1. The Governments of the Member States of the European Communities and the Commission of the European Communities wish to take advantage of the opportunity offered by the U.S. Government to comment on the proposed Federal Unitary Taxation Spreadsheet Legislation published by the Department of the Treasury on 8 July 1985.

They welcome the publication of the aforementioned proposed legislation as a contribution to a satisfactory solution of the problem of worldwide unitary taxation. They would like, however, to point out that some aspects of the proposed legislation cause concern to them.

2. The main areas of concern to the Governments of the Member States of the European Communities and the Commission arise from the definitions of "qualified state" and of "worldwide unitary basis". Under the proposed legislation, notwithstanding the fact that it applied a worldwide combination, a state would qualify in three cases:

(a) failure to comply with legal and procedural requirements;

(b) failure of the taxpayer or a foreign government to provide information after proper request;

(c) failure of separate accounting to prevent evasion of taxes.

On (a) the Governments and the Commission subscribing to this note object to the application of the system of worldwide unitary taxation. They equally object to the imposition of this method of taxation as a sanction to achieve certain legal or procedural requirements. Worldwide unitary taxation leads to a distortion in the international attribution of income for taxation purposes. The imposition of fines would seem to them the appropriate way of dealing with non-compliance.

On (b) the proposed legislation mentions failure of a foreign Government to provide information sufficient to determine the arm's length nature of transactions within a reasonable period of time as a ground for returning to worldwide unitary taxation.

Even when double taxation agreements have been revised, the Governments and the Commission are concerned that the draft

legislation does not provide adequate safeguards against information provided under treaties, and passed on to the States, being used other than for the purpose of applying unitary taxation to the relevant corporation.

The Governments and the Commission assume that, pending revision of treaties which, in their present form, do not allow the passing on to qualifying states of information provided by a foreign tax administration to the Internal Revenue Service, this provision does not subject their companies to worldwide unitary taxation. Further, these Governments and the Commission assume that inability on their part to provide information sought by states does not entail the imposition of worldwide unitary taxation.

On (c) the proposed legislation mentions failure to prevent evasion of taxes or clearly reflect income, even after appropriate adjustment, as a ground for imposing worldwide unitary taxation. The Governments and the Commission joined in these representations are unclear when such a case would occur. Separate accounting, where necessary adjusted for deviations from arm's length conditions, is the internationally agreed yardstick to measure the international distribution of income for taxation purposes. They, therefore, fear this case will cause much uncertainty for their taxpayers.

With respect to the definition of the worldwide unitary basis the Governments and the Commission note that the proposals almost entirely reproduce the concept of the water's edge combined group as defined by the Working Group under the chairmanship of Secretary Regan, as he then was. As they have pointed out earlier, this definition still causes them concern on a number of points. The Governments and the Commission refer in this respect to the letter of 16 January 1985 from the Chairman of the OECD Committee on Fiscal Affairs to Secretary Regan. In particular they are concerned about the thresholds for foreign companies to be included in the water's edge combination and about the definition of tax havens; the treatment of banks and certain other financial institutions is also unsatisfactory.

They would urge the Department of the Treasury:

(a) to substitute for the thresholds mentioned in the proposal the internationally accepted criterion of permanent establishment, and to tax foreign companies having a permanent establishment within the United States on a separate entity basis. This is the approach recommended to the States by former Secretary Regan in his letter to President Reagan on August 31, 1984.

(b) to bring the definition of tax havens into the proposed legislation and to align it with the guidelines accepted by the OECD countries (*).

(c) to insure that banks and other financial institutions are treated for tax purposes as subsidiaries, hence removing the present discrimination against such institutions arising from the fact that they generally operate on a branch or agency basis.

3. The Governments and the Commission welcome the proposed legislation as a contribution towards finding an internationally acceptable solution for the problems of worldwide unitary taxation. The proposed legislation in its present form, however, would offer federal assistance to States that have adopted or intend to adopt legislation which does not meet the concerns of these Governments and the Commission. Thus this legislation falls short of providing a stimulus to the States to adopt legislation that would actually solve this long-standing problem in a satisfactory way.

4. Our Governments and the Commission wish to express the hope that the Federal Government will continue to exert all its influence to convince the States of the necessity of finding an internationally acceptable solution to the unitary tax issue, or failing that, will propose further legislation of its own to achieve the same objective.

Washington, D.C.
August 30, 1985

(*) A tax haven is broadly defined as any country or territory which promotes improper shifting or sourcing of income or expenditure by virtue of its tax structure and/or tight banking or commercial secrecy provisions.

EXHIBIT 32LL

European Communities

EUROPEAN PARLIAMENT

Working Documents

1983-1984

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27 October 1983 DOCUMENT 1-967/83

MOTION FOR A RESOLUTION

tabled by Mr WELSH, Mr GAUTIER, Mrs GREDAL, Mr LANGE, Mr MOREAU, Mr BLUMENFELD, Mrs MOREAU, Sir Fred CATHERWOOD, Mr PROVAN, Mr SPENCER, Mr TYRRELL, Mr DELOROZOY and Mrs VEIL

for entry in the Register
pursuant to Rule 49 of the Rules of Procedure

on taxation of companies by American States

THE EUROPEAN PARLIAMENT

A. Noting that a number of American States have adopted a world wide system of taxing companies on an imputed percentage of their profits known as Unitary Tax, effectively taking profits earned outside the USA,

B. Aware that the US Supreme Court has accepted the legality of such a system for domestic US corporations,

C. Concerned that this decision may be taken to extend to American companies with subsidiaries in Europe and the American subsidiaries of Community based companies,

1. Considers that the principle of Unitary Tax is contrary to the spirit of the various double taxation treaties and discriminates unfairly against European based companies with operations in the United States.
2. Regrets that the United States Administration did not file an Amicus Curiae Brief in the Supreme Court case of Container Corporation of the US vs. California Trustees which would have enabled the position of overseas Companies to be clarified.
3. Urges the Administration to give full hearted support to legislation before the Congress which would exempt overseas Companies from this discriminatory form of tax.
4. Urges the Commission to instruct its Delegation in Washington to continue to press this matter which can only damage relations between the Community and the United States to the detriment of their mutual economic and political interests.
5. Believes that failure by the Administration and Congress to act in this way would justify the suspension of the double taxation treaties by the Member States.
6. Instructs its President to forward this resolution to the President of the Commission, the Head of the US Mission to the European Communities and the Chairman of the Delegation of the US Congress to the European Parliament.

EXHIBIT 34

Wednesday
10 July 1985

Volume 82
No. 152

HOUSE OF COMMONS
OFFICIAL REPORT

PARLIAMENTARY DEBATES (HANSARD)

Wednesday 10 July 1985

LONDON
HER MAJESTY'S STATIONERY OFFICE
£1·95 net

NEW CLAUSE 27

WITHDRAWAL OF RIGHT OF CERTAIN NON-RESIDENT COMPANIES TO PAYMENT OF TAX-CREDITS

(1) This section applies to a company which has, or is an associated company of a company which has, a qualifying presence in a unitary state and, at any time when it or its associated company has such a qualifying presence, is entitled by virtue of arrangements having effect under section 497(1) of the Taxes Act (relief by agreement with other countries) to a tax credit under section 86 of the Finance Act 1972 (tax credit for certain recipients of qualifying distributions) in respect of qualifying distributions made to it by companies which are resident in the United Kingdom which is equal to one half of the tax credit to which an individual resident in the United Kingdom would be entitled in respect of such distributions.

(2) Schedule (*Supplementary provisions as to withdrawal of tax credits*) to this Act has effect to supplement the provisions of this section.

(3) Notwithstanding anything to the contrary in the arrangements referred to above and subject to paragraph 2 of the said Schedule, a company to which this section applies shall not be entitled to claim under subsection (4) of the said section 86 to have the tax credit referred to in subsection (1) above set against the income tax chargeable on its income for the year of assessment in which the distribution is made or, where the credit exceeds that income tax, to have the excess paid to it.

(4) A company shall be treated as having a qualifying presence in a unitary state if it is a member of a group and, in any period for which members of the group make up their accounts ending after the relevant date, 7½ per cent, or more in value of the property, payroll or sales of such members situated in, attributable to or derived from the territory outside the United Kingdom, of which that state is a province, state or other part, are situated in, attributable to or derived from that state.

(5) For the purposes of subsection (4) above —

(*a*) 7½ per cent. or more in value of such property, payroll or sales as are preferred to in that subsection shall be treated as being situated in, attributable to or derived from the state there referred to, unless, on making any claim under sub-section (4) of the said section 86, the claimant proves otherwise to the satisfaction of the Board, and

(*b*) the value of the property, payroll or sales of a company shall be taken to be the value as shown in its accounts for the period in question and for this purpose the value of any property consisting of an interest in another member of the group or of any sales made to another such member shall be disregarded.

(6) In this section "the relevant date" means the date on which this section comes into force or, if earlier, the earliest date on which a distribution could have been made in relation to which the provisions of this section are applied by an order made under this section.

(7) This section shall come into force on such date as the Treasury may by order made by statutory instrument appoint and the Treasury may in addition by order made by statutory instrument —

(*a*) prescribe that the provisions of this section shall apply in relation to distributions made on or after a date before that on which the order bringing them into force is made, being a date not earlier than 1st April 1985.

(*b*) prescribe those provinces, states or other parts of a territory outside the United Kingdom which are to be treated as unitary states for the purposes of this section, and

(*c*) prescribe that for subsections (4) and (5) of this section (or for those sub-sections as they have effect at any time) there shall be substituted either the following provisions —

"(4) A company shall be treated as having a qualifying presence in a unitary state if it is subject to tax in such a state for any period ending after the relevant date for which that state charges tax.

(5) For the purposes of subsection (4) above a company shall be regarded as subject to tax in a unitary state if it is liable there to a tax charged on its income or profits by whatever name called and shall be treated as so charged unless it proves otherwise to the satisfaction of the Board.".

or the following provisions —

"(4) A company shall be treated as having a qualifying presence in a unitary state if it has its principal place of business in such a state at any time after the relevant date.

(5) For the purposes of subsection (4) above

(*a*) a company shall be treated as having its principal place of business in a unitary state unless it proves otherwise to the satisfaction of the Board, and

(*b*) the principal place of business of a company shall include both the place where the central management and control of the company is exercised and the place where the immediate day-to-day management of the company as a whole is exercised."

(8) No order shall be made under this section unless a draft if it has been laid before and approved by a resolution of the Commons House of Parliament.".— [*Mr. Grylls.*] *Brought up, and read the First time.*

Mr. Michael Grylls (Surrey, North-West): I beg to move, That the clause be read a second time.

Mr. Deputy Speaker (Sir Paul Dean): With this it will be convenient to take amendment No. 57 — new schedule —

'SUPPLEMENTARY PROVISIONS AS TO WITHDRAWAL OF TAX CREDITS

'Recovery of tax credits incorrectly paid

1. — (1) Where the provision of section [*Withdrawal of rights of certain non-resident companies to payments of tax credits*] of this Act apply so as to withdraw the entitlement of a company to claim to have a tax credit in respect of a qualifying distribution set

against the income tax chargeable on its income and to have the excess of the credit over that income tax paid to it and the company (in this paragraph referred to as "the recipient company") has either had that excess paid to it, or has received an additional amount in accordance with arrangements made under Regulation 2(1) of the Double Taxation Relief (Taxes on Income) (General) (Dividend) Regulations 1973, it shall be liable to a fine for the violation of the provisions of section [*Withdrawal of right of certain non-resident companies to payment of tax credits*] of this Act equal to twice the amount of the excess or additional amount as the case may be and such fine (in this section referred to as "the recoverable amount") shall be payable to the Board and treated as having become payable at the date when the excess or additional amount was paid to the recipient company and may be recovered in accordance with subparagraphs (2) to (5) below.

(2) The recoverable amount may be assessed and recovered as if it were unpaid tax and section 30 of the Taxes Management Act 1970 (recovery of overpayment of tax, etc) shall apply accordingly.

(3) Any amount which may be assessed and recovered as if it were unpaid tax by virtue of this paragraph shall carry interest at the rate of 9 per cent. per annum from the date when it was payable in accordance with this paragraph until the date it is paid and it is hereby declared that this paragraph applies to a recoverable amount which is paid without the making of an assessment (but is paid after it is due) and that where the recoverable amount is charged by any assessment (whether or not any part of it has been paid when the assessment is made), this paragraph applies in relation to interest running before, as well as after, the making of the assessment.

(4) Where the recoverable amount is not paid by the recipient company within six months from the date on which it became payable —

(*a*) the recoverable amount may at any time within six years from the date on which it became payable be assessed and recovered as if it were unpaid tax due from any person who is or

was at any time prior to the expiration of the said six year period connected with the recipient company, or would have been connected on the assumption that all the facts and circumstances relating to the recipient company at the time the excess or additional amount as the case may be was paid continued to apply for six years thereafter, and section 30 of the Taxes Management Act 1970 shall apply accordingly, and

(*b*) as respects its accounting periods beginning with that in which the excess or additional amount referred to in sub-paragraph (1) above was paid and ending with that following that in which the recoverable amount is paid in accordance with the provisions of this paragraph, the company which made the qualifying distribution in respect of which the recipient company received the excess or additional amount shall not be entitled to set any advance corporation tax paid by it against its liability to corporation tax for such periods in accordance with section 85 of the Finance Act 1972 (payments of advance corporation tax to be set against company's liability to corporation tax on its income) nor to surrender the benefit of the whole or any part of any amount of advance corporation tax to a subsidiary in accordance with section 92 of that Act (*setting of company's surplus advance corporation tax against subsidiary's liability*) in such periods.

(5) Where a recoverable amount is assessed and recovered from a person connected with the recipient company in accordance with sub-paragraph (4)(*a*) above, that person shall be liable for the interest payable in accordance with sub-paragraph (3) above and, until the interest is so paid, sub-paragraph (4)(*b*) above shall apply as if the words "the interest due in accordance with sub-paragraph (3) above is paid" were substituted for the words "the recoverable amount is paid in accordance with the provisions of this paragraph".

(6) Interest payable under this paragraph shall be paid without any deduction of income tax and shall not be allowed as a deduction in computing any income, profits or losses for any tax purposes.

(7) Where under the law in force in a territory outside the United Kingdom interest is payable subject to a deduction in respect of taxation and such deduction applies to an amount of interest paid in accordance with sub-paragraph (3) above, the reference to the rate of 9 per cent. per annum in that sub-paragraph shall be deemed to be a reference to such rate of interest as after such deduction shall be equal to the rate of 9 per cent. per annum.

Claims to payment of tax credits following remedial legislation in unitary states

2. — (1) This paragraph has effect where a company to which section [*Withdrawal of right of certain non-resident companies to payment of tax credits*] applies has a qualifying presence in a province, state or other part of a territory outside the United Kingdom which has been prescribed as a unitary state for the purposes of that section and, at the time when a qualifying distribution is made to that company by a company which is resident in the United Kingdom, that state has enacted legislation the effect of which is that, as from a future date which shall not be later than 31st December 1986, it will cease to be a unitary state within the meaning of the definition in paragraph 5(1) below, notwithstanding that it remains prescribed as such for the purposes of that section.

(2) In the circumstances described in sub-paragraph (1) above the company in receipt of the qualifying distribution shall be entitled on or after the effective date to claim to have the tax credit to which it is entitled in respect of the distribution set against its liability to income tax and to have the excess (if any) of the credit over that liability paid to it: but, if payment of the excess or of the additional amount referred to in Regulation 2(1) of the Double Taxation Relief (Taxes on Income) (General) (Dividend) Regulations 1973 is made before the effective date, the provisions of paragraph 1 above shall apply in relation to that payment regardless of the enactment of the legislation referred to in sub-paragraph (1) above.

(3) For the purposes of this paragraph the effective date shall be deemed to be the date (not to be later than 31st December 1986) on which the legislation referred to in sub-paragraph (1) above actually becomes effective in the province state or other Kingdom multinational group, although that has no conceivable relevance to the group's activities in the United States, and in that state in the United States.

That reporting system makes a nightmare of business planning and investment by multinationals, by creating uncertainty as to the tax due in a state such as California. I ask the House to consider the situation in a London headquarters company with a subsidiary in California, which is therefore subject to Californian unitary tax. That subsidiary in California cannot know its tax liability without supplying the state authorities with such details as payroll, property and equipment in every other country throughout the world in which that British multinational operates.

The House may be interested to have an example, which brings the matter home. It is the case, which has been well written up, of the subsidiary of the EMI group, Capitol Records. It is in California, and now part of the Thom EMI group. The Capitol Records subsidiary was asked to provide information on a worldwide reporting basis. It sent that request from the Californian state authorities to its headquarters in London, which wrote to the Californian state authorities saying, "We would love to give you this information, and would normally be happy to do so, but we happen to be a defence contractor for Her Majesty's Government, and we have signed the Official Secrets Act. If we give you this information, we shall be put in prison, so we shall not do it, even for the Californian tax authorities." The company then suffered a 25 per cent. penalty clause for non-disclosure of information from London and other parts of the world. That illustrates the unpredictability and irrationality of such taxation.

The sheer unpredictability and illogicality of such a method of tax assessment threatens investment and trade. Above all, it strikes a blow at the internationally accepted principles of taxation by creating tax liabilities in a state which bear no direct relation to profits earned in that state. For the purposes of state taxation, the method can turn a company's loss in a state into a profit by

bringing in the worldwide figures. Perhaps more seriously, it burdens companies with the unproductive work of creating and producing information and translating it into dollars from the foreign currencies in which those subsidiary companies operate. That is not sensible. An example of this is that the worldwide accounts of companies must be recomputed in dollar terms and must conform to American accounting standards. That is especially offensive when a state — a political subdivision of a nation — attempts to carry out what is, in effect, foreign policy. I am sure that those who created the constitution of the United States did not intend that the individual states should carry out foreign policy by asking for information in that way.

To draw an analogy closer to home, it is as though Lambeth borough council asked for worldwide information from an American company whose United Kingdom subsidiary was based in Lambeth. That would be an impertinence and an abuse of the powers of Lambeth borough council. I am sure that it would do no such thing. That is comparable with what is happening in some American states. It runs counter to all the work that has been done. Through double taxation treaties, the United States and Britain have worked for many years to eliminate barriers to trade and investment, which were created, understandably, by the variety of tax systems in the world. The arms-length system of taxation embodied in our treaty network and that of the United States is the international standard and the custom of nations. It is recognised by the OECD and by the United Nations. The use of the worldwide reporting system violates that standard.

I should run through what has happened since the United Kingdom-United States treaty was being negotiated in 1975, because the history of what happened is the basis of new clause 27. When the current treaty was being negotiated in 1975, it contained a clause — clause 9(4) — which would effectively have barred unitary tax. That would have been fine. Unfortunately, although clause 9(4) was passed by a majority in the Senate, it was not passed by the necessary two thirds majority, and it failed. By this American action, Britain was placed in the position of either rejecting the entire treaty — some would describe that as throwing out the baby with the bathwater — or of

accepting it without clause 9(4). The House, rightly, accepted the treaty, subject to assurances from Ministers that they would press for an early resolution of the issue, backed by assurances from the United States that it would use its best endeavours to secure an early solution.

On 18 February 1980, the then Minister of State — my right hon. and learned Friend the present Chief Secretary — said:

"To those who remain concerned about the unitary question, I say that there is no disposition on the part of the Government to let the issue die. If the house approves the convention and if it is ratified thereafter, we shall be prepared to place on record, for all to see, our reservations on the unitary system. The Administration of the United States were left in no doubt by what I told them . . . We do not propose to bury the issue if the House gives its approval to the convention and the three protocols." — [*Official Report*, 18 February 1980; vol. 979.c. 179-99.]

When ratification took place on 25 March 1980 — entering into force on 25 April 1980 — the British Government expressed to the United States Administration strong disapproval of the world-wide combined reporting system. In a note to the United States Administration, the Government said:

"It must be emphasised however that the acceptance of the Senate reservation" —

taking our clause 9(4) —

"in no way implies approval of the unitary basis and that it is the urgent request of Her Majesty's Government for the reasons given above that the Government of the United States should use its best endeavors to eliminate the international application of the unitary basis of taxation".

United States' companies received substantial tax concessions as a result of the treaty in return for the inclusion of clause 9(4) prohibiting the use of unitary tax. Clause 9(4) was to be, in the words of the then Senator Morgan, who participated in that debate in the Senate, "a concession for a concession".

I believe that in 1980 the House would not have ratified the treaty without United States' assurances that the unitary tax problem would be solved.

Since 1980 there have been various attempts in the United States Congress, as my colleagues who visit the United States regularly will know, to put through a Bill outlawing unitary tax. It is odd that, despite general antipathy in Washington towards this unfair system, so far none of these Bills has succeeded in being passed. It seems that, whenever a Bill has approached the winning post, another general election has been called, and the whole process has had to start again. I suppose that we have the same problem here. During this period the United Kingdom Government and many other Governments have pressed vigorously for an end to this perverse system.

I should like to pay a warm tribute to the staff of the British embassy in Washington who, over these five or Kingdom multinational group, although that has no conceivable relevance to the group's activities in the United States, and in that state in the United States.

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I should like to pay a warm tribute to the staff of the British embassy in Washington who, over these five or seven years, have worked hard to resolve this issue. I pay particular tribute to the Economic Secretary in the embassy, Mr. Harry Walsh, who has

just returned to London. He had become one of the great experts there. He slaved away on this issue and worked tirelessly to produce a solution. I should like to thank the British consulates at the state level which have negotiated and done what they can. I pay tribute also to Treasury Ministers and their officials in the United Kingdom, in the Foreign and Commonwealth Office and especially in the Inland Revenue, who have borne the burden of this continuing problem.

Two years ago on 12 July 1983 my right hon. Friend the Chancellor in a letter to the then Treasury Secretary, Donald Reagan, said that he was

"keen for the matter to be resolved . . . before harm is done between our two countries."

I emphasise that quotation, because hon. Members and all the British people do not want in any way to damage our relations with our strongest and, perhaps, favourite ally. I think that my right hon. Friend the Chancellor had that point very much in mind. However, the problem has not been resolved.

In September 1983 President Reagan set up a working group to look into the problem. The Prime Minister, who was visiting Washington at that time, chivvied the President to resolve the issue and, with commendable farsightedness, warned the Administration:

"We might be under very severe pressure to take retaliatory action."

Two years later we find ourselves having to do just that.

12.15 am

I pay tribute also to the efforts of my right hon. Friend the Secretary of State for Trade and Industry. He lobbied for industry during his recent visit to California and I know that was helpful.

By the autumn of 1983, despite all the efforts that had been made, three years had passed and the promises of 1980, which I have quoted, to resolve the issue had not been met. Frustration and impatience were being expressed in Westminster and British firms were becoming increasingly caught up in a tax nightmare. I

hope that the House will feel strongly that it is our duty and that of the Government to protect the interests of individuals travelling abroad and those companies that operate abroad.

In April 1984, seven months later, there were no signs of progress from the United States working group. I went to Washington to announce details of a retaliatory clause that we had tabled last year. The clause had the support of many of my hon. Friends. Unfortunately, and I believe mistakenly, the Government refused to back the clause and to have a debate last summer, almost precisely at this time of year. They claimed that it was premature to retaliate.

There is no doubt that the tabling of the clause in 1984 alerted United States opinion to the real possibility of legislation being enacted in Westminster to retaliate against them. As a result of publishing the clause last year, there was evidence of fresh activity in the United States against the continuation of unitary tax. There were clear signs of United States companies working hard to get rid of it.

When the clause was not inserted in the Finance Bill 1984, it seemed that United States corporations saw that the threat of retaliatory action had receded. Later in 1984, the working group reported. It recommended what it described as a "water's edge" solution. At that time the United States Treasury Secretary wrote to the President as follows:

"If there are not sufficient signs of appreciable progress by the States in this area by 31st July next year whether by legislation of administrative action, I will recommend to you that the Administration propose federal legislation that would give effect to a water's edge limitation patterned after that in the Chairman's Report."

That was the result of the working group's activity.

I pay tribute to the states that have repealed their unitary tax provisions since then — including Oregon, Florida and Colorado — but it is important that during the debate the United States Administration is left in no doubt that the House does not regard the action by those states as being enough to constitute "apprecia-

ble progress" in removing unitary tax and that it does not constitute a real solution to the problem. It is not our job to pick off states one by one.

The problem will not be met until California and the other five unitary states have passed satisfactory legislation, or until the federal Administration has produced a solution that will stand for the whole United States. In many ways a federal solution would be the best one.

Over the past year, attempts — unfortunately all in vain so far — have been made in Sacramento, the state capital of California — to progress legislation on unitary tax. I am grateful to the governor of California for the personal efforts that he has made to seek a solution to the unitary tax problem. Only two weeks ago I went to California to see what progress was being made and, perhaps more importantly, to express the continuing anger and frustration of many in the House and in British industry that so little progress had been made.

United States business men whom I met, and Japanese business men, all told me that they wanted a solution to the problem. That view is shared by our European Community partners, especially the Netherlands, France and Germany, and by Japan, Canada and Switzerland. However, satisfactory legislation in one form or another still eludes us seven years after the treaty was signed and after assurances were given to the House of Commons. This House, which has been patient almost to a fault during that period, can no longer wring its hands and hope that something will be done. The time for action has come. We must apply leverage on the United States to secure a complete, satisfactory and final solution to this irritating problem. That is the reason for new clause 27.

Since the first retaliatory clause was tabled in 1984, extensive consultations have taken place with business and lawyers to try to provide in this new retaliatory clause a greater element of flexibility for the Government when deciding how widespread the United Kingdom countermeasures should be. When it is triggered by statutory instrument, the clause would withdraw payments of tax

credits to United States companies with a substantial business presence in unitary tax states — for example, California.

There are three options. Depending upon which of the three options the Government choose, the trigger will affect United States companies in the United Kingdom which have 7.5 per cent. or more of their property, payroll or sales in a unitary tax state, or which are subject to tax on income in a unitary tax state, or which have their principal place of business in a unitary tax state. Those are the three triggers that the Government will have at their disposal if the House decides to accept the new clause. My hon. Friend the Member for Tatton (Mr. Hamilton) who is a very experienced lawyer has been working with me on this new clause. He will expand a little further, if he catches your eye, Mr. Deputy Speaker, on the details.

The House will want to know what advice those hon. Members who have sponsored the new clause will be giving to the Government about when they should activate one of the three triggers. Such a decision will not be easy for my right hon. Friend the Chancellor of the Exchequer and his colleagues in Government. I pay tribute to them for having expressed considerable sympathy for the clause and for enabling this debate to take place. Rather like marriage, retaliation against a friend and ally is not something to be entered into lightly.

We must all hope that if this new clause is passed it will succeed in inspiring action in California and the other unitary tax states during the remaining few weeks of the 1985 legislative session. We must also hope that it will inspire action in Washington and that they will lobby the federal Government to use their influence to solve this problem. If they do not, I hope that my right hon. Friend the Chancellor of the Exchequer will not flinch from pulling a trigger which will hit United States companies where it hurts: on their bottom line. That would produce a response.

If the new clause is successful in motivating the United States Administration, the states and business to secure a solution to this problem, the trigger could be released just as quickly as it had been pressed.

I pay tribute to the determination of the 50 companies which some years ago formed themselves into the unitary tax campaign which has worked very hard to solve this problem. A number of the companies benefit from the application of unitary tax. Despite that, they believe that the principle is wrong and they vigorously oppose it. I pay tribute to them for their stand. I pay tribute also to the chairman of the unitary tax campaign, Mr. Peter Welch, and to Professor Peter Whiteman, QC, a highly skilled lawyer who has helped us to draft the new clause. If the new clause is accepted, the House will owe him a great debt. The CBI, too, should be praised for its action in sending a mission earlier this year to California.

Although I have criticised the Government for resisting the pressure for retaliation in 1984, I am the first to say that the Government, including the Chancellor, the Foreign Secretary and the Financial Secretary, have shown admirable resolution and determination in pressing for a solution to the problem. I hope that the House will approve the new clause and that the Financial Secretary will agree that the time has come to put these powers on to the statute book.

Dr. Marek: I was interested in the remarks of the hon. Member for Surrey, North-West (Mr. Grylls) and to hear the long roll call of people who have been involved in the campaign and the various actions that they had taken to arrive at the position which we are discussing tonight.

However, missing from the hon. Gentleman's comments was any justification from the point of view of, say, California as to why that state felt that it had no option other than to institute unitary taxation. The hon. Gentleman said that such taxation could, in a particular example, change a loss into a profit. That may be so from an examination of the company's books, but it may not be so from a careful examination of whether transfer pricing between different parts of the company — remembering that we are talking about multinationals — has taken place between one country and another. That is the problem facing us as we consider the new clause.

Companies do not have a code of morality and say, "We honestly believe that we made 20 per cent. of our profits as a multinational in the United Kingdom, so we will pay 20 per cent. of the tax to the UK, and the respective rates of tax in all the countries in which we operate." Multinationals will, by and large, try to minimise the tax that they pay worldwide, and rightly so. If, say, in California wage rates, land taxes or whatever are high, multinationals will minimise the tax that they pay in California and maximise the tax that they pay in, say, Taiwan and Korea. The same is true of multinationals based and registered in this country.

For a company that is based in this country and has much of its business in America, it gets caught by way of unitary taxation, and there is a real problem for such companies. There is an inherent unfairness in a system by which some states apply the normal code of taxation and others apply unitary taxation because, in effect, that creates double taxation, and that hits particularly hard those companies which are registered in, say, the UK but have a substantial trading interest in a country which applies unitary taxation, such as California. It is clear, therefore, that the system is not fair. For that reason I hope that the new clause will be accepted.

However, price fixing and transfer pricing by multinational companies operates not to the benefit of this country. It is not to the benefit of this county. Having said that, I do not think that affects the issue of unitary taxation. It ought to be looked at but not now.

I wish the new clause well. We cannot have two systems working side by side. We will either have to have one or the other. We do not have unitary taxation, there is no prospect of it coming, therefore it is sensible to see if we can get rid of it.

12.30 pm

Sir Eldon Griffiths (Bury St. Edmunds): I very rarely speak in finance debates. I am quite sure that the rule of the road should be brevity, but I have perhaps some small credentials to speak in this matter because I have spent virtually the whole of my

political and personal life as a devotee of the United States. I went to college there. I earned my living there for some 17 years. I bought my first house there. I was married there. I have a son there who is a banker. I am a director of two American companies. I visit the United States many times each year and I have the honour of representing, indirectly no doubt, some 23,000 American airmen who have the good fortune to be stationed in my constituency. So I make no bones about it. The United States is my second home and my dearest wish in politics is that the Anglo-American alliance shall continue to be the bulwark of freedom and prosperity in the western world.

But there is one thing that I have never been able to stand when it comes from the United States and that is the attempt occasionally to export American policies beyond the water's edge and to impose them on other people. They tried that at the federal level in respect of the Soviet Federal Government have shown a certain sensitivity over this, or at least that has been the stated reason for slow progress, but the Federal Government must make far greater use of the opportunity they have to bring pressure to bear on the states to change.

Two events which occurred in 1983 are worth mentioning. First of all, there was the decision in the Container Corporation case, where the Supreme Court of the United States determined that unitary taxation was not outlawed by the constitution. But that was a majority decision with a strong dissent, and the United States Justice Department was not briefed to appear in that case but attempted to appear after it ended. The commission set up by Secretary Regan, which reported in July 1984, looked at the matter in a certain way. In particular it recommended that unitary taxation should be restricted to the water's edge; in other words, confined to taxing as a unit a company's activities within the United States.

According to the Unitary Taxation Campaign, there are still nine states with unitary taxation, which means that they go across the water's edge. There seems to be some disagreement as to the precise number of states. Some Treasury Ministers put the figure at six and the Library told me it was seven. Perhaps the Financial Secretary could elucidate on that. When the Regan commission

reported, it set a deadline of 31 July 1985 for the states to take action on unitary taxation. That deadline is fairly close now, and I hope that this new clause, if it is passed, will give the Government a negotiating weapon. It will be a sign of our seriousness of intent to allow the federal and state governments to recognise exactly what we are contemplating.

New clause 27 meets the injustice of unitary taxation with the fairly rough justice of retaliation. Were a state to be designated by an Order of the House, any company with a qualifying presence within that state would not be able to claim back the refund of ACT under the double taxation treaty. That is a fairly heavy penalty for those companies with a qualifying presence in that state to bear. One hopes that that will encourage them to put pressure on their own state Governments to change their attitude towards unitary taxation.

It is right that the House will have to approve an order before the new clause can come into operation. We are expressing the seriousness of our concern, but we are saying, "We do not want to go all the way until they have had another chance to put their house in order." The new clause will force the pace towards abolition of unitary taxation.

12.45 am

The British Insurance Association and a number of insurance companies are worried about the difficulties that could arise for them if the new clause is implemented. I should like an assurance from the Financial Secretary that their representations would be taken into account before it was decided to put an order before the House.

It is important that the new clause has all-party support and that the House is united in identifying the problem and in its desire to ensure that discrimination against British companies is prevented. If it is felt that an order should be put before us — we hope that the need for that will not arise — it would be wise for the Opposition to be kept fully informed of the state of play, so that the all-party support can be retained. It is important that we should act as one.

The issue is important to British firms. We hope that the United States Government and the state governments will note the strong feeling of both sides of the House and will act voluntarily, rather than wait for the threat of retaliation to become actuality.

Sir William Clark: I support my hon. Friend the Member for Surrey, North-West (Mr. Grylls). Like him, I have been battling for years against unitary taxation.

I wholeheartedly agree with the hon. Member for Sedgefield (Mr. Blair) that it is a great boost to our battle that the new clause has all-party support. The Financial Secretary would be wise to note the comments of the hon. Member and to stress to the United States Government that we are not making party points.

I am sorry that the hon. Member for Wrexham (Dr. Marek) brought in multinational companies. We do not want to complicate the issue. We are talking about unitary tax and that has nothing to do with multinational companies.

The hon. Member for Sedgefield mentioned the worries of the British Insurance Association. It fears that if we take action against the United States the fourth convention will be cancelled. I cannot envisage that happening. The fears of the BIA are unfounded.

We are talking about an iniquitious tax which is anti-investment in the United States. We have well over $30 billion of investment abroad. As my hon. Friend the Member for Surrey, North-West said in a speech which everyone has commended for its clarity and lucidity, British companies own well over 20 per cent. of all foreign investment in the United States.

When I was in Washington before the presidential election I met Mr. McClure, the chairman of the working party set up by the President, and I told him in no uncertain terms what Back Benchers on both sides of the House thought of unitary tax. I warned him — and I am glad that the Prime Minister said much the same thing to the President — that pressure from both sets of Back Benches would be such that our Government would have to

give way eventually, whether on the next Budget or the one after that.

Here we are at the next Budget. The United States has not taken on board what unitary tax could lead to. There is a great deal of British and American investment in Third-world countries. If any country thinks it legitimate and good business to have unitary tax, it would be disastrous for overseas investment for both the United Kingdom and the United States. I accept that this is retaliatory action. We can control only what we control, and we control only advanced corporation tax. That means on a £100 gross dividend that instead of an American investor receiving £85, in future he will receive only £70 because he will not get the 50 per cent. reduction in ACT. That should be pressed home because the latest figures show that the ACT concession for the United States is well above £300 million. If American companies, which invest in the United Kingdom and receive British dividends, realise that their income is at risk, the Federal Government may come under more domestic pressure.

Two events which occurred in 1983 are worth mentioning. First of all, there was the decision in the Container Corporation case, where the Supreme Court of the United States determined that unitary taxation was not outlawed by the constitution. But that was a majority decision with a strong dissent, and the United States Justice Department was not briefed to appear in that case but attempted to appear after it ended. The commission set up by Secretary Regan, which reported in July 1984, looked at the matter in a certain way. In particular, it recommended that unitary taxation should be restricted to the water's edge; in other words, confined to taxing as a unit a company's activities within the United States.

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It is right that the House will have to approve an order before the new clause can come into operation. We are expressing the seriousness of our concern, but we are saying, "We do not want to go all the way until they have had another chance to put their house in order." The new unitary clause will force the pace towards abolition of unitary taxation.

I recognise that the Federal Government have difficulties in that the states are autonomous. On the other hand, if we had inserted the clause about outlawing unitary tax in 1975, it would have been mandatory on all the states because the sovereignty of the Federal Government in Washington means that they can sign an international agreement which binds all the states.

We must bring pressure to bear on the Washington Government to end this iniquity. We are approaching 31 July and we cannot allow the present position to continue. I earnestly hope that my hon. Friend the Financial Secretary will accept the clause, and that he and the Chancellor of the Exchequer will trigger off the three points made by my hon. Friend the Member for Surrey, North-West. That is the only way to bring home to the Americans that we mean business and that unitary tax must cease.

Mr. Pike: I shall speak only briefly because the hon. Member for Surrey, North-West (Mr. Grylls) argued the case well, and my hon. Friend the Member for Sedgefield (Mr. Blair) made the

points that I intended to make. I support the new clause because it takes the right line. It is unfortunate that the line that the Government have pursued for many years has been unsuccessful in achieving the result for which we have wished. If the Government accept the amendment and it is carried, I hope that it will not be necessary to trigger the lines of action proposed in the clause, and that the Government will not find it necessary to return to the House for an order to take retaliatory action. I hope that California and the Federal Government realise that we mean business and that we intend to ensure free trade.

My hon. Friend the Member for Wrexham (Dr. Marek) referred to multinational companies, but the hon. Member for Croydon, South (Sir W. Clark) took his comments out of context. The new clause has all-party support, as has the early-day motion, in spite of doubts among my right hon. and hon. Friends about multinationals.

I have some doubts and fears about multinationals, but I recognise the importance of the taxation rather than the trade issue. It is significant that, despite fears and worries, Opposition Members are prepared to support the early-day motion and the new clause. I hope that the new clause is accepted and that it is not necessary to trigger the orders. I hope that the California authorities in particular will wake up and realise that we mean business. The House as a whole is saying that if they do not, we shall, unfortunately, have to retaliate. We hope that we do not have to take that action.

Mr. Neil Hamilton: I have a small qualification to take part in the debate because, when the double tax treaty was about to be ratified back in 1979, I wrote a book on the topic — one of the few ways in which members of the Bar can draw their presence to the attention of solicitors. A few hundred copies of the book survive and can be obtained at discount rates. I never quite made the Jeffrey Archer class, so I never needed to take advantage of the provisions of the double tax treaty in relation to the international earnings which I received from that book.

The topic has concerned British industry for a long time, so it is important to examine the way in which the clause is drafted and

to discover why particular words are used rather than the alternatives which might have been used. It is important to recognise that this is merely enabling legislation which might never be used if the appropriate remedial action is taken.

As my hon. Friend the Member for Croydon, South (Sir W. Clark) said, the financial consequences of the new clause would be severe for many companies if we had to activate its provisions. It would deny tax credit equivalent to £15 on a £100 dividend to the parent company in the United States which would otherwise benefit from the repatriation of profits from United Kingdom subsidiaries.

The companies affected are those which have a substantial presence in the unitary tax state which operates the worldwide combined reporting system. The qualifying presence is defined as applying to a United Kingdom subsidiary which is a member of a group which has 7.5 per cent. or more of its property payroll or sales in a unitary tax state. That formula is used deliberately, because it is that which is used in the unitary tax states themselves and will therefore be familiar to companies oeprating there.

It is important to know that those firms' property payroll or sales are disjunctive and not conjunctive and therefore that if any one of them gives rise to the 7.5 per cent. trigger, the clause will affect all the companies which operate in that state. This is important to United States corporations because they already have to compile the information for state taxes. It is therefore available and will not involve any extra administrative costs to provide it to the Inland Revenue.

The 7.5 per cent. test could have been applied to income and we could have given ourselves extra lift, but we decided to reject that because conceptual problems might otherwise have arisen — such as whether we should choose gross or net income and whether it should be income for United States tax purposes or for the tax purposes of some other jurisdiction. It seemed much simpler to restrict ourselves to the tried and tested formula of the unitary tax states.

Why have we chosen 7.5 per cent.? Many right hon. and hon. Members have said that the main problem is California. I am

convinced that, if California takes the lead in getting rid of unitary tax, the other states will follow. California accounts for about 12.5 per cent. of American gross domestic product. That means that most American companies might come into the net if we have to activate new clause 27. Although, on that basis, the average company would have 12.5 per cent. of its assets in California, the figure pitched that high would have left many companies out of the net. We considered that the same was true for 10 per cent., so the next logical step seemed 7.5 per cent.

Why did we not go lower? In this respect, the other states that apply income tax come into play. The other states are small and there are few companies in the United States that would have more than 7.5 per cent. of their profit, payroll or sales in a state such as North Dakota. It seems that 7.5 per cent. is adequate to catch enough companies in California so that pressure can be put on the state legislature to remove the unitary tax provisions. If California repeals, the effect of the new clause is spent. Some states are not as legislatively busy as the rest of us. North Dakota, for example, has a lively system — its state legislature does not meet at all next year so, without a special session, it will be unable to conform to the new clause.

The onus of proof of entitlement to the tax credit for a company that would otherwise be caught by the new clause lies on the company, not the Inland Revenue. That means that the company must prove that it is not in the unitary tax net. It is not for the Revenue to dispute with the company its coming within the ambit of the clause, but for the company to prove that it can take advantage of the double tax treaty.

The Treasury should act early or, once again, people in California will assume that we are not serious and that this is just so much huffing and puffing. I do not think that the consequences that have been feared would necessarily follow from early action. Under subsection (7)*(a)*, the orders that the Treasury would have to lay can be backdated to 1 April 1985. That blocks any avoidance possibilities by which United States corporations could attempt to avoid the clause by repatriating massive dividends now and draining their subsidiaries in Britain of funds. As that is a possibility, but as we do not want to create too much uncertainty

in international trade, there should be as little retrospection as possible. We should therefore have action as quickly as possible.

There are two alternative figures to the 7.5 per cent. test to which I have already referred. One is a wide alternative trigger and the other is a narrow one. On the basis of the wide alternative the Revenue would be able to trigger the proposals in the new clause in relation to any company which has a qualifying presence in, for example, California by virtue of having any of its income subject to state taxes in that country. The narrower definition would mean that the principal place of business of the company should be in the unitary tax state. This gives enormous flexibility to the Revenue but also creates uncertainty. The states which operate unitary tax systems should realise that there is a wide battery of possibilities open to us and that we are determined that the new clause will be effective if it ever needs to be put into effect. That should encourage states to take early action to remove the cause of difficulty.

If by some mischance a company tries to evade or avoid the ambit of the new clause, a variety of penalties are provided in the new schedule. A fine could be levied equal to twice the tax credit. This type of fine is important as it entails the company not just repaying the tax credit that it has already received but suffering a fine equivalent to the tax credit plus an equivalent amount on top. That is important because, under the internal revenue code of the United States, fines are not deductible from corporate profits for tax purposes, so it would increase the cost to US corporations attempting to avoid or evade the new clause.

Interest is set at the rate of 9 per cent. under paragraph 1(3) of the new schedule, effective from the time when the tax credit is paid. The loss of the right to settle is covered in paragraph 1(4)*(b)*, which provides for a loss of the right to settle advance corporation tax on the dividend which cannot then be set against mainstream corporation tax liability. The right to settle is not only lost for the accounting period in which the tax credit is paid to the company but can be carried forward indefinitely if there is any excess or surplus available for that purpose.

Various avoidance techniques might be used to try to get around the working of the clause but I believe that we have effectively prevented them from succeeding. For example, what would happen if the United States parent company refused to pay the fine? Paragraph 1(4)*(a)* of the new schedule provides that the fine can be recovered from the United Kingdom subsidiary or from any connected company. What if the United Kingdom subsidiary pays the dividend and the parent company then liquidates the subsidiary to try to circumvent the clause? The liquidated company is deemed to exist for a further six years and if a new subsidiary is formed in its place within six years that company will be liable for the accumulated fines in relation to the original infraction. Thus, both simple liquidation and liquidation followed by reincorporation will be ineffective.

If a United Kingdom subsidiary or connected company pays the interest or the fine on behalf of the United States corporation, that will not be deductible for corporation tax purposes in this country. The purpose of that provision is to recapitulate for our own tax regime the effect of a fine not being deductible for tax purposes under the American internal revenue code.

The United States parent company subjected to fines and interest will have to pay the interest gross whereas normally the withholding of tax is deducted first and the interest is paid to the recipient net. That, too, will reduce the benefit of attempting to avoid the purposes of the clause.

The hon. Member for Wrexham (Dr. Marek) and others have referred to the use of creative accounting techniques, but I believe that we have prevented the use of such techniques by paragraph 3(1) of the new schedule. For example, if a United States parent company lends a United Kingdom subsidiary, say $1 billion and then charges 10 per cent. interest on the loan as a notional transaction intended to convert what would otherwise have been paid by way of dividend to a payment by way of interest, that too will be covered because the new schedule provides that interest paid where it is reasonable to suppose that a qualifying distribution would otherwise have been made will not avoid the provisions of the new clause.

The draconian powers of inspection and requirement of information in paragraph 4 are based on the controlled foreign companies provisions rushed through the House last year without debate and with the connivance of the Opposition, so I hope that both Front Benches will approve of that insertion of those provisions.

The measure that we propose is draconian, but desparate diseases require desperate remedies and that is the situation in which we now find ourselves. I repeat, however, that the effect of the new clause can be avoided by timely action by the states concerned. If repealing legislation is passed by 31 December 1986, even if the new clause is put into effect in the meantime, the United States corporations affected will get their 15 per cent. tax credit and will be no worse off than they now are even if the repealing legislation was not in force when the distribution payment was made. I believe that that will be a great incentive to action by California and I hope that the authorities there will take the hint.

It may be argued that we are setting a precedent, but I believe that the United States has already set the precedents. For example, the United States double tax treaty with France came into being as a result of a threat of retaliatory action of the kind that we propose today. Section 891 of the American internal revenue code sets that out, so in a sense we are simply following the action of the United States and not setting a precedent of our own.

It may be argued that our proposal overrides the double tax treaty and that that itself is a precedent. If the proposals were triggered off, they would certainly override the provisions of that treaty, but there are precedents for that in the United States. For example, the Foreign Investment in Real Property Tax Act 1980 which became effective on 1 January this year specifically overrides all the double tax treaties entered into by the United States with all countries around the world. The Americans have thus introduced domestic legislation of their own which overrides international obligations entered into freely by treaty; and that was a unilateral move on their part.

In relation to our own double tax treaty, too, the United States has overridden one of the articles. There is therefore a precedent for action in that context, too, in so far as the American Internal Revenue Service has made a ruling which overrides the provisions of the treaty in relation to insurance premiums received by United Kingdom insurance companies.

I believe, therefore, that this measure is timely and necessary. I do not believe that it will lead to retaliation by the United States. I believe that the Federal Government are determined to see an end to this problem in the interests of their own international trade and that the cost to United States companies of inaction by the Californian authorities will be very great indeed. If the Government support the new clause today they will do a great service not just to the cause of business in this country but to the whole international trading and business community.

I commend the new clause to my hon. Friend the Financial Secretary and I hope that what he has to say today will be trumpeted across the Atlantic as a meaningful and determined attempt to declare war upon a system of taxation which is as unjust and damaging to the interests of the United States as it is to the interests of this country and of all other countries affected by it.

1:15 am

Mr. Wrigglesworth: I support the motion, and urge others to support it. It is timely, as the hon. Member for Tatton (Mr. Hamilton) said. Some would say that it is long overdue. When the tax treaty came before the House, we had the opportunity to exert considerable pressure on the Administration, and, through the Administration, upon the states in the United States, to rectify the situation that had arisen. Although assurances were given, action did not result to the extent that we had hoped.

I have come firmly to the conclusion that only this sort of retaliation will pay the dividends that we want. In the mid-1970s I remember discussing the matter with Governor Brown in California and trying to get him to see the sense of the argument that was being put to him. It was clear that he was not going to budge

an inch, and that no other state government would, unless there was a clear reason for them to do so, in responding to their own electorate and their interests. The only way in which we can bring that about is by putting on the pressure proposed in the new clause.

Therefore, I hope that the House will give its full support to the new clause and that the Government will enthusiastically welcome it as a means to put pressure upon the Federal Government and through them on the state legislature, so that this ridiculous situation can be resolved.

Mr. Moore: I shall try to be brief, but the House will understand that it is essential that I express with great care and clarity the Government's attitude to the clause.

This has been a major debate on an issue of great importance to the United Kingdom, the United States and all our trading partners. If I may say so, the speech of my hon. Friend the Member for Surrey, North-West (Mr. Grylls) was fully in keeping with the importance of the issue. The House is indebted to him and his colleagues — I specifically mention my right hon. Friend the Member for Taunton (Sir E. du Cann), who is not with us tonight but who has been long active in the campaign, and my hon. Friends the Member for Croydon, South (Sir W. Clark), for Bury St. Edmunds (Sir E. Griffiths), and for Tatton (Mr. Hamilton). It is important that on the issue we have had consistent all-party support. I particularly welcomed the speech by the hon. Member for Sedgefield (Mr. Blair), representing the official Opposition, that of the hon. Member for Stockton, South (Mr. Wrigglesworth), and the continued presence throughout the debate of the hon. Member for Roxburgh and Berwickshire (Mr. Kirkwood). It is crucial that we have a clear signal on whatever we do in the area. The consistent all-party support has been a key feature of the debates on the issue.

It is clear that my hon. Friend the Member for Surrey, North-West spoke for the whole House when he referred to the widely felt frustration that a solution to the problem has been so long delayed. It is equally clear that he spoke for the House when he said that the time had come for Parliament to take legislative

action to register the United Kingdom's determination to see that a solution of the problem is achieved in the United States. That was borne out by contributions to the debate from all parts of the House. It is reinforced by the number of hon. Members — again from all parts of the House — who have put their names to the new clause on the amendment paper.

I should like to make it clear that the Government strongly endorse everything that has been said in the debate about the imposition of unitary taxation on United Kingdom-controlled companies and other non-American corporations.

The basic objection to unitary tax is that it is contrary to the internationally accepted principle for allocating profits where a company or group operates internationally. That is that tax authorities charge tax on foreign-owned companies only on the profits arising in the country or state for which they are responsible. The arm's-length method is recognised by both the Organisation for Economic Cooperation and Development and United Nations, and is enshrined in a worldwide network of bilateral double taxation treaties including the treaties to which the United States is party. It provides a coherent and consistent tax framework for international trade and investment.

As applied by states such as California, the unitary tax method applies a formula apportionment to the worldwide profits of a multinational group to establish the tax due in California. In doing so, a unitary state is reaching beyond the borders of its own jurisdiction and taxing profits earned outside it, and thus breaching the internationally accepted principles.

For individual companies, as many hon. Members have said, that means unfair tax bills and excessive compliance costs. It can also produce double taxation. Income earned by the foreign parent of a United States subsidiary is taken into account in the unitary tax bill, and taxed without any relief for overseas tax. Multinational groups can be taxed on more than 100 per cent. of their income in a particular state, and a loss can be turned into a taxable profit. Another serious objection is the excessive compliance burden imposed by worldwide unitary tax. The method inevitably involves financial information on the worldwide activities of the group, which can be extremely burdensome in practice. It is objectionable that a state tax authority should demand information about the financial records of United Kingdom companies, and their subsidiaries, which are outside the United States and unrelated to activities within the United States.

If unitary tax continues, it will distort investment decisions. The immediate effect is to damage inward investment in the states that impose it. There is increasing recognition in the United States that it is, therefore, in the economic interest of such states to remove it.

The damage goes wider than that. If unitary tax continues, it will disrupt the internationally accepted taxation framework, and have a damaging effect on the development of world trade. The importance of a solution is, therefore, self-evident.

A speedy resolution of the problem is especially important to the United Kingdom, because the cumulative total of United Kingdom investment in the United States is now more than $32 billion. This is more than any other country and represents nearly a quarter of all foreign direct investment in the United States. In 1983 alone, the United Kingdom invested more than $3.7 billion in the United States, which accounted for 32 per cent. of the total of foreign direct investment in the United States in that year.

The American Administration recognised this as long ago as 1977, when the United Kingdom and America negotiated a provision in the tax treaty to prevent individual states from applying the unitary method to United Kingdom companies. The proposed treaty was ratified by the House of Commons in 1977. However, article 9(4) was rejected by the United States Senate in 1978. The United Kingdom Government were then assured that the United States Administration would use their best endeavours to secure a solution.

Since then, there has been some progress, but not enough. There was a major setback as the hon. Member for Sedgefield (Mr. Blair) said, when the United States Supreme Court ruled in the Container case that the California worldwide unitary method

was not unconstitutional, at least so far as it was applied to a United States parent corporation and its foreign subsidiaries.

However, a working group was set up under the then Treasury Secretary Regan to seek to resolve the issue. The group reached a consensus on the general principle that unitary taxation should be limited to the United States water's edge. But it left important issues on the application of that general principle unresolved. In his Report to the President in July 1984, Secretary Regan said that these issues should be left for resolution at state level. However, he also said that if there were not,

"sufficient signs of appreciable progress by the states,"

by 31, July 1985, he would recommend to the President that the Administration propose federal legislation to give effect to a water's edge limitation.

It is right to recognise the importance that the United States Administration attaches to securing a solution, which will — as Secretary Regan put it — enable the United States,

"to speak with one voice in dealing with its foreign trading partners,"

so that,

"this irritant to international commercial relations will have been eliminated".

It is clear that there is a common objective. Some progress has been made at state level since the working group reported. Six states have now repealed or modified the worldwide application of unitary tax. But in some cases, the state legislation does not provide a comprehensive limitation on the application of unitary tax to United Kingdom groups. In five states, legislative initiatives have failed to succeed. In California, the key state to the United Kingdom, a legislative initiative last year was unsuccessful. Despite the Governor's efforts to achieve a solution and intense activity by key legislators, the chances of satisfactory legislation passing this year are in serious doubt.

It is against this disappointing background that the House must consider the legislation proposed in the clause and schedule.

Before we contemplate the passage of this legislation, we should ask whether we in the United Kingdom have done enough to impress on our friends in the United States the importance we attach to the issue. I think the answer must be yes. This has been confirmed by all we have heard in the debate. The Government have lost no opportunity to urge a speedy solution on the United States Administration, and have done so at the highest levels. The Administration have been well aware of the strong parliamentary pressure for legislative action if such a solution was not forthcoming. In the past year, when the focus has been on action at states level, there has been vigorous and concerted activity by the United Kingdom Government and industry. Government and industry teams have gone to Florida, Colorado, Utah and North Dakota in the past 12 months. Since last July, United Kingdom teams have visited California on four separate occasions. These included a major delegation led by Sir Terence Beckett of the CBI in February this year. I would like to pay tribute to the energy and resource displayed by the CBI, the Unitary Taxation Campaign — especially its chairman, Peter Welch — and other representatives of British business in trying to secure a resolution of the problem. As my hon. friend said, a similar tribute should be paid to our officials in the Embassy in Washington and in the other American consulates and, if I may say so, especially to our officials in the Inland Revenue.

Despite all this activity from the Government and industry, and from other countries, a resolution of the problem still remains in doubt. The Government have therefore concluded that it is right that the enabling powers proposed in the clause should be passed into legislation, and we so recommend to the House.

The hon. Member for Sedgefield (Mr. Blair) asked for two assurances. I happily give an assurance that the Government will take account of respresentations on behalf of the insurance industry, to which the hon. Gentleman particularly referred. Of course, that would extend to the rest of British industry. I recognise the absolute importance of obtaining all-party support. I cannot give an absolute undertaking in this matter, as clearly we cannot anticipate events and circumstances. However, I take the hon. Gentleman's comments very much into account. It is clearly

far better to retain a united parliamentary front. As the hon. Gentleman said, the House will have time to reflect and vote under the affirmative order procedure.

The powers in the clause and schedule, if invoked, would deprive United States parent companies of tax credit on dividends paid by their subsidiaries in the United Kingdom. They could have a major impact on the finances of such companies. At the extreme, they could cost these companies as much as £500 million a year.

The Government will not, of course, recommend to the House that these enabling powers should be invoked without the most careful consideration and consultation with all those concerned. It is important that if it becomes necessary to invoke the reserve powers there should be a degree of flexibility in specifying the companies and states that will be affected. My hon. Friend the Member for Surrey, North-West (Mr. Grylls) made a convincing case for this when he explained the changes that he has introduced into his clause to provide the maximum flexibility for the Government if a resolution were laid to bring the powers into effect.

I conclude, however, by expressing the earnest hope that it will prove unnecessary for the United Kingdom to invoke the reserve powers in the clause. I very much hope that our friends in the United States — in the Administration, the states and business — will soon be able to secure a satisfactory solution to the problem of their own volition. There is a common interest in solving the issue. The basis of that solution is common ground between the United States Administration, states and business. We trust that the United States will now be able to overcome the remaining obstacles to achieving a complete and enduring solution to this problem, by action in the states or by federal action.

In this spirit, I commend my hon. Friend's clause and schedule to the House.

Mr. Grylls: With permission, I should like to respond to the debate. I reiterate the all-party support for this measure. It is important that a signal should go to the United States that the House is determined in this matter and that the threat of

retaliatory action will not go away until the problem is solved. In that spirit, I hope that the house will accept the new clause.

Question put and agreed to.

Clause read a Second time and added to the Bill.

EXHIBIT 35

FINANCE ACT 1985

CHAPTER 54

LONDON
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£10-40 net

FINANCE ACT 1985

CHAPTER 54

ARRANGEMENT OF SECTIONS

PART I

CUSTOMS AND EXCISE AND VALUE ADDED TAX

CHAPTER I

CUSTOMS AND EXCISE

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* * *

[Withdrawal of right of certain non-resident companies to payment of tax credits. 1972 c.41.]

54.—(1) This section applies to a company which has, or is an associated company of a company which has, a qualifying presence in a unitary state and, at any time when it or its associated company has such a qualifying presence, is entitled by virtue of arrangements having effect under section 497(1) of the Taxes Act (relief by agreement with other countries) to a tax credit under section 86 of the Finance Act 1972 (tax credit for certain recipients of qualifying distributions) in respect of qualifying distributions made to it by companies which are resident in the United Kingdom which is equal to one half of the tax credit to which an individual resident in the United Kingdom would be entitled in respect of such distributions.

(2) Schedule 13 to this Act has effect to supplement the provisions of this section.

(3) Notwithstanding anything to the contrary in the arrangements referred to above and subject to paragraph 2 of the said Schedule, a company to which this section applies shall not be entitled to claim under subsection (4) of the said section 86 to have the tax credit referred to in subsection (1) above set against the income tax chargeable on its income for the year of assessment in which the distribution is made or, where the credit exceeds that income tax, to have the excess paid to it.

(4) A company shall be treated as having a qualifying presence in a unitary state if it is a member of a group and, in any period for which members of the group make up their accounts ending after the relevant date, 7½ per cent. or more in value of the property, payroll or sales of such members situated in, attributable to or derived from the territory outside the United Kingdom, of which that state is a province, state or other part, are situated in, attributable to or derived from that state.

(5) For the purposes of subsection (4) above—

(*a*) 7½ per cent. or more in value of such property, payroll or sales as are referred to in that subsection shall be treated as being situated in, attributable to or derived from the state there

referred to, unless, on making any claim under subsection (4) of the said section 86, the claimant proves otherwise to the satisfaction of the Board, and

(*b*) the value of the property, payroll or sales of a company shall be taken to be the value as shown in its accounts for the period in question and for this purpose the value of any property consisting of an interest in another member of the group or of any sales made to another such member shall be disregarded.

(6) In this section "the relevant date" means the date on which this section comes into force or, if earlier, the earliest date on which a distribution could have been made in relation to which the provisions of this section are applied by an order made under this section.

(7) This section shall come into force on such date as the Treasury may by order made by statutory instrument appoint and the Treasury may in addition by order made by statutory instrument—

(*a*) prescribe that the provisions of this section shall apply in relation to distributions made on or after a date before that on which the order bringing them into force is made, being a date not earlier than 1st April 1985,

(*b*) prescribe those provinces, states or other parts of a territory outside the United Kingdom which are to be treated as unitary states for the purposes of this section, and

(*c*) prescribe that for subsections (4) and (5) of this section (or for those subsections as they have effect at any time) there shall be substituted either the following provisions—

"(4) A company shall be treated as having a qualifying presence in a unitary state if it is subject to tax in such a state for any period ending after the relevant date for which that state charges tax.

(5) For the purposes of subsection (4) above a company shall be regarded as subject to tax in a unitary state if it is liable there to a tax charged on its income or profits by

whatever name called and shall be treated as so charged unless it proves otherwise to the satisfaction of the Board."

or the following provisions—

"(4) A company shall be treated as having a qualifying presence in a unitary state if it has its principal place of business in such a state at any time after the relevant date.

(5) For the purposes of subsection (4) above—

(*a*) a company shall be treated as having its principal place of business in a unitary state unless it proves otherwise to the satisfaction of the Board, and

(*b*) the principal place of business of a company shall include both the place where the central management and control of the company is exercised and the place where the immediate day-to-day management of the company as a whole is exercised."

(8) No order shall be made under this section unless a draft of it has been laid before and approved by a resolution of the Commons House of Parliament.

EXHIBIT 36A
No. 176—Part II

Vol.131 WASHINGTON,
WEDNESDAY, DECEMBER 18, 1985 NO. 176

Congressional Record

PROCEEDINGS AND DEBATES OF THE 99TH CONGRESS, FIRST SESSION

STATEMENT BY THE PRESIDENT

Since early in this Administration, we have been working with the states, the business community, and foreign governments in an effort to resolve issues related to state use of the worldwide unitary method of taxation. At this time I believe it appropriate for the Federal Government to state its support for the concept of legislation that would:

1. Effect a requirement that multinationals be taxed by states only on income derived from the territory of the United States ("the water's edge of requirement"); and

2. Address the question of equitable taxation of foreign source dividends.

We hoped that by this time these principles would have been enacted by the various states that have unitary taxation. Since states have not universally accepted these principles, I am instructing the Secretary of the Treasury to initiate the process of crafting Federal legislation to incorporate these principles into law and to work with the Congress for passage, and also, where appropriate, to enter into negotiations to amend double taxation agreements. I am also instructing the Secretary of the Treasury to pursue enactment of the domestic "spread-sheet" legislation, which has been previously proposed, and which is designed to assist nonunitary states with tax enforcement respecting multinational corporations in order to promote full taxpayer disclosure and accountability.

Further, I am instructing the Attorney General to ensure that the United States' interests are represented in appropriate controversies and cases consistent with this approach.

EXHIBIT 36B

UNITED STATES OF AMERICA
Congressional Record

PROCEEDINGS AND DEBATES OF THE 96TH CONGRESS
FIRST SESSION

VOLUME 125 — PART 14

JUNE 29, 1979 TO JULY 13, 1979

(PAGES 17319 TO 18652)

UNITED STATES GOVERNMENT PRINTING OFFICE,
WASHINGTON, 1979

* * *

[p. 17427] EXECUTIVE SESSION

ESTATE AND GIFT TAX TREATY WITH THE FRENCH REPUBLIC; PROTOCOL TO THE INCOME TAX CONVENTION WITH THE FRENCH REPUBLIC; THIRD PROTOCOL TO THE 1975 TAX CONVENTION WITH THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND, AS AMENDED; ESTATE AND GIFT TAX TREATY WITH THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND; TAX CONVENTION WITH THE REPUBLIC OF KOREA;

TAX CONVENTION WITH THE HUNGARIAN PEOPLE'S REPUBLIC

The PRESIDING OFFICER. The Chair is sorry to break in, but by previous order of the Senate he must do so at this time.

Under the previous order, the hour of 1:50 p.m. having arrived, the Senate will now go into executive session and proceed to the consideration of six treaties: Executive J (96th Congress, 1st session), Estate and Gift Tax Treaty with the French Republic; Executive K (96th Congress, 1st session), Protocol to the Income Tax Convention with the French Republic; Executive Q (96th Congress, 1st session), Third Protocol to the 1975 Tax Convention with the United Kingdom of Great Britain and Northern Ireland, as amended; Executive R (96th Congress, first session), Estate and Gift Tax Treaty with the United Kingdom of Great Britain and Northern Ireland; Executive P (95th Congress, 2d session), Tax Convention with the Republic of Korea; and Executive X (96th Congress, 1st session), Tax Convention with the Hungarian People's Republic. Debate thereon will be limited to a total of 10 minutes, to be equally divided and controlled by the Senator from New York (Mr. JAVITS) and the Senator from Idaho (Mr. CHURCH).

Who yields time? If no time is yielded, the time runs equally against both parties.

Mr. CHURCH. Mr. President, today the Senate has before it six tax treaties or protocols to existing tax treaties. These are: First, a protocol to the existing income tax treaty with France, second, an estate and gift tax treaty with France, third, a protocol to the pending income tax treaty with the United Kingdom, fourth, an estate and gift tax treaty with the United Kingdom, fifth, an income tax treaty with Hungary, and sixth, an income tax treaty with South Korea.

The Committee on Foreign Relations held public hearings on the proposed tax treaties and protocols on June 6, 1979. On June 12, 1979, they were considered by the committee and ordered favorably reported without reservation by a unanimous vote of the committee with a recommendation that the Senate give its advice and consent to their ratification.

The witnesses at the hearings included several experts in the area of international taxation and representatives of several organizations interested in the area as well as witnesses representing taxpayers who would be affected by the treaty. There was a general concensus that these treaties and protocols are sound, that on balance they are beneficial to the United States and its taxpayers, and that they should be approved.

The only objection to the approval of these treaties and protocols was made by the International Association of Drilling Contractors to a provision contained in the protocol to the United Kingdom income tax treaty. That provision would generally allow the United Kingdom to tax U.S. independent drilling contractors operating in its waters and would allow the United States to tax British contractors operating in U.S. waters. Following the hearings, however, the objection to the approval of the treaty was withdrawn by the U.S. drilling contractors. A telegram to that effect appears at page 58 of the committe report accompanying the United Kingdom protocol.

In view of the absence of controversy as to the approval of these treaties and protocols, I will keep my comments very brief. I would, however, like to comment on one aspect of the protocol to the pending United Kingdom income tax treaty.

The pending treaty was approved by the Senate during the last Congress with a reservation which deleted a provision which would have restricted the manner in which States of the United States could tax British multinational corporations through the application of the unitary method of apportionment. This protocol deletes that State taxation provision in conformity with the Senate's reservation. In the testimony on this protocol, those who wish to see limitations placed on the rights of the States to use the unitary method have made it clear that they support the approval of this protocol. However, they have also attempted to utilize this protocol as a vehicle to promote Federal legislation which would prohibit the States from using the unitary method.

I wish to make it clear that while I agree that this is an area that should be investigated with an open mind by the committees which would have jurisdiction, it is not a simple question. Any

limitation by the Federal Government on the taxing powers of the States raises a number of very serious issues. There is the obvious issue of federalism — the Federal Government should interfere with the States' taxing powers only with great reluctance. This is particularly true in an area such as this where there is a great deal of controversy as to whether the unitary method used by the States or the arm's-length method used by the Federal Government is the better method of apportionment of income.

In this connection, I ask unanimous consent to have printed in the RECORD a letter from the California Franchise Tax Board challenging the arguments made by those testifying in favor of Federal legislation limiting the rights of the States to tax.

There being no objection, the letter was ordered to be printed in the RECORD, as follows:

FRANCHISE TAX BOARD,
Sacramento, Calif., June 13, 1979.

In reply refer to 410:BFM:kf
HON. FRANK CHURCH,
Chairman, Senate Foreign Relations Committee, Russell Senate Office Building, Washington, D.C.

DEAR SENATOR CHURCH: Thank you for the opportunity to testify at the Committee's hearing on June 6, 1979, and for the opportunity which you extended to us to submit supplemental comments.

In reviewing the testimony offered by Senator Mathias and Marlow W. Cook, we are struck by the apparent basic misconception of the unitary method upon which their testimony is based. The unitary method does not place a tax on the worldwide income of any business enterprise. The unitary method is a means of determining the amount of income which is properly attributable to a geographic area. As stated in Section 25101, California Revenue and Taxation Code, it is a means of determining a tax "measured by the net income derived from or attributable to sources within this state." This fact has been recognized by the United States Supreme Court for over 50 years. *Bass, Ratcliffe & Gretton, Ltd.* v. *State Tax Commissioner,* [p. 17428] 266 U.S. 271 (1924). *Underwood Typewriter Company* v. *Chamberlian,*

254 U.S. 117 (1920), and is, in fact, constitutionally mandated when the corporation subjected to tax is not domiciled or incorporated in the state.

To state that "international multiple taxation is the inevitable result, if not the fundamental purpose, of the unitary tax system" is absurb.

Senator Mathias, in his statement, alleges that the opponents of Article 9(4) conceded that the question of the application of the unitary method should be legislatively addressed. This is not correct. The states objected to the use of the treaty process to circumvent full consideration by both Houses of Congress. The states, however, do not believe that a problem exists which requires federal legislation. A review of the printed record of the hearings held by Senator Mathias on what is currently Senate Bill 983 will reveal that not a single state supported the legislation proposed in the income tax area.

Mr. Cook's testimony reveals his misunderstanding of California's application of the unitary method. Under California court decisions the use of the unitary method is required, *Honolulu Oil Corp.* v. *Franchise Tax Board,* 60 Cal. 2d 417 (1963), *Superior Oil Co.* v. *Franchise Tax Board,* 60 Cal. 2d 406 (1963).

The Franchise Tax Board has no discretion in this matter. (The language authorizing separate accounting in Section 25137, California Revenue and Taxation Code, applies only where segments of a corporation are parts of different unitary businesses or give rise to nonbusiness income.) California's test of what constitutes a unitary business remains the same. Either the three-unities test. *Butler Bros.* v. *McColgan,* 17 Cal. 2d 664, 315 U.S. 501 (1941) or the contribution and dependency test, *Edison California Stores, Inc.* v. *McColgan,* 30 Cal. 2d 472 (1947) must be met. Ownership of more than 50 percent of the stock of a subsidiary is not sufficient to establish unity. In point of fact, a court in San Francisco has recently ruled that a 51.5 percent owned subsidiary was not unitary even though the other unitary elements were satisfied. *ASARCO* v. *Franchise Tax Board,* San Francisco Superior Court Docket No. 712-405.

Mr. Cook also states that the states are seeking to tax income which the Internal Revenue Service has decided is foreign source income under section 482 of the Internal Revenue Code. As pointed out previously, the unitary method does not tax such income. But more importantly, the Internal Revenue Service has not classified such income as foreign source income under Section 482. The taxpayer has so classified the income, and the Internal Revenue Service, in order to attach such characterization, must rely on Section 482; but this is a far different state of facts than Mr. Cook's assertion that "the Secretary of Treasury has determined, for federal income tax purposes, income property should be allocated under Section 482 of the Internal Revenue Code to foreign operations..." Finally, Mr. Cook should examine the summary and explanation of President Carter's 1978 Tax Program where the Treasury specifically criticizes ineffectiveness of Section 482. (Pages 282-297)

Finally, Mr. Cook refers to the United States Supreme Court's recent decision in *Japan Lines, Ltd.* v. *County of Los Angeles*, (April 30, 1979). Even a cursory reading of the opinion makes it obvious the Court was addressing a very limited question involving *ad valorem* property taxes and specifically so limited its decision. Of particular note was the Court's failure to even discuss, let alone overrule *Bass, Ratcliffe & Gretton, Ltd., supra*, a decision dealing directly with the imposition of a state income tax on a foreign country corporation, utilizing a formula method to determine the measure of the tax. The Court has clearly not ruled the unitary method inapplicable to foreign corporations. If, in fact, the Court should so rule, then the need for Article 9(4) and Senate Bill 983 would be obviated.

In conclusion, we urge that the Senate Foreign Relations Committee approve the United States — United Kingdom Tax Convention and the Protocols attached thereto without any reservation or recommendation on Senate Bill 983.

Very truly yours,
BRUCE W. WALKERS,
Chief Counsel.

Mr. CHURCH. In conclusion, these tax treaties and protocols will be of substantial benefit to U.S. taxpayers doing business or living in the countries involved. The proposed treaties and protocols with the United Kingdom and France represent important modernizations in our treaties with those countries and reflect changes in the domestic laws of the countries involved since the treaties were last negotiated. For example, under the pending United Kingdom Income Tax Treaty which is contingent upon approval proposed United Kingdom protocol. U.S. investors in United Kingdom corporations will receive British tax refunds at a rate of approximately $100 million a year. The proposed French protocol would alleviate double taxation of U.S. citizens resident in France which would otherwise result from recent changes in French jurisdictional tax rules. The proposed treaties with Korea and Hungary represent important expansions of our treaty programs with developing countries and countries of eastern Europe.

Mr. President, these treaties are significant steps in reducing non-tariff barriers to trade and in alleviating double taxation. I urge that the Senate give its advice and consent to their ratification.

The PRESIDING OFFICER. The time of the Senator from Idaho has expired. The Senator from New York has 4 minutes.

Mr. JAVITS. Mr. President, I rise in support of the six tax treaties with the United Kingdom, France, South Korea, and Hungary that are before us today. The Foreign Relations Committee has held hearings on all the treaties and has ordered them favorably reported by a vote of 13 to 0, with the recommendation that the Senate give its advice and consent to ratification of each of the Treaties.

While each treaty is significant with respect to the regularization of tax relations between the United States and the particular county, it is the United States-United Kingdom Tax Treaty that has received special attention for well over 2 years. While I advocated last year ratifying that tax treaty without reservation, I am, nevertheless, pleased that today we will be acting favorably on the amended text.

The problem caused by the continued ability of the states to use worldwide combination under the unitary tax system remains, however. It is imperative that an equitable solution be found since our companies operating overseas may one day find themselves subject to such worldwide combination by political subdivisions of other countries. It will be very difficult for the U.S. Treasury to defend the interests of our corporations against such taxation practices in information tax treaty negotiations until we have resolved the issue in the United States. I call the attention of my colleagues to the fact that, in its report on the United States-United Kingdom Tax Treaty, the Foreign Relations Committee urged the tax writing Committees of the Congress — the Finance Ways and Means Committees — to hold hearings on S. 983, the interstate taxation bill introduced by Senator MATHIAS, which would accomplish legislatively for all nations what article 9(4) of the United States-United Kingdom Tax Treaty sought to accomplish for the United Kingdom. Resolution of this issue is critical for the maintenance of a favorable climate for foreign investment in the United States, and the Congress should have the opportunity to take a position on the merits of the issue.

While the issues raised by article 9(4) will continue to be important and must be resolved, we have before us a balanced tax treaty, which provides substantial benefits to both the United States and the United Kingdom. Once ratified here, I hope that the Parliament will consider expeditiously the treaty so that these benefits can begin to accrue to each side.

Both the number of tax treaties we have before us today and of those that are in the various stages of negotiation underline the new-found importance of these treaties in resolving the conflicts that result from different national taxation systems. The existence of such treaties facilitates the free flow of capital among countries and, hence, is an important element in the growing interdependence of the various national economies.

To assist the Senate with its constitutional duties, I shall ask the chairman of the Foreign Relations Committee to have the committee undertake a thorough study of our tax treaty program. Such an in-depth analysis, which would include hearings with expert witnesses from the administration and private sector, could

focus on the emerging requirements for tax treaties resulting from these conflicts in national taxation systems and whether the procedures followed by the Treasury for both public and congressional involvement in the tax treaty making process are adequate and whether and how they could be improved. I look forward to working very closely with the distinguished chairman of the Foreign Relations Committee as well as with the international tax experts of the Joint Committee on Taxation in this endeavor.

Mr. WALLOP. Mr. President, the United States-United Kingdom Tax Treaty has been the subject to considerably controversy, particularly its attempted limitation on the States in taxing foreign source income. When the Senate considered the treaty last June, article 9(4) was essentially removed by reservation. During Senate consideration at that time, some Senators argued that the appropriate forum for discussions [p. 17429] of limitations on the States should involve both Houses of Congress.

In the March 8, 1977 House Ways and Means Committee report dealing with State taxation of foreign source income, several pertinent questions were addressed. I ask unanimous consent that part IV of the report (pages 25-30) be printed in the RECORD following my remarks.

The PRESIDING OFFICER. Without objection, it is so ordered.

(See exhibit 1.)

Mr. WALLOP. I also would like to point out that Senator MATHIAS has introduced legislation, S. 983, which addresses the problem of States' rights to use the worldwide combined reporting system. Because of the controversy and complexity of the issue, I hope that Congress will have an opportunity to fully examine this question.

EXHIBIT 1

IV. STATE TAXATION OF FOREIGN SOURCE INCOME

Present law and background

General structure of State taxation of corporations. — The question of State taxation of foreign source income is one aspect

of the larger question of State taxation of businesses operating in more than one State. This larger question involves the problem of determining a State's jurisdiction for taxing a corporation's income and uniform rules for apportioning and allocating that income among the States in which a corporation does business. Of the 45 States which impose a corporate income tax, all use some kind of formula to apportion business income between the various States in which a corporation operates. However, the specific formula used varies substantially from State to State.

In determining income earned within a State, most States (30 out of 45) use some variation of a basic three-factor apportionment formula. Under this formula the income of a corporation is apportioned to each State according to the average ratio of three factors: the sales, payroll, and property values of the corporation. For example, a corporation which has one-half of the value of its property, three-fourths of its payroll, and one-fourth of its sales in a particular State would take the average of these three fractions (one one-half) to determine the amount of income subject to tax in that State.[1]

A State's apportionment formula is usually applied only to income of a corporation where the business activity from within the State is dependent upon, or contributes to, business activities of the same corporation outside of the State. Ordinarily, in a case where the business activity in the State is unrelated to other businesses of the corporation outside of the State, all of the income from that business within that State is allocated to that State (and the income from the other businesses is not allocated to the State).

[1]The 15 States which do not follow this three-factor formula use other apportionment formulas, some based on property values only and others based on a combination of sales and property or sales and payroll or property and payroll. Even among those States which do use the basic three-factor formula, the manner of measuring the three items in the formula may differ. For example, in some States a sale is taken into account by the State where the sale originated (generally, the location of the seller) while in other States the sale is allocated to the State of destination (generally where the buyer is located).

Some States, primarily California and Oregon, have adopted what is known as the "unitary method" of applying the three-factor apportionment formula. Under this method the formula is applied not only to the income of the specific corporation operating in the State but also to any income of related corporations (subsidiaries, parent corporations, or brother-sister corporations) where the related corporations' activities outside of the State are dependent upon or contribute to the business of the corporation within the taxing State.

In many States, not all of the income of a corporation is subject to that State's apportionment formula. For example, in many States passive income such as dividend income is allocated entirely to the State of the "commercial domicile" (or in some cases the State of the "principal business location") of the corporation and is thus excluded from the income subject to the apportionment formula.

Taxation by States of foreign source income. — Virtually all States include the income of foreign branches of domestic corporations in the income which is subject to their apportionment formula. For example, if a corporation had two-thirds of its sales abroad, but the other one-third of its sales, one-half of its property, and two-thirds of its payroll in one State, the corporation would be taxed on one-half of its income by that State.

In those States which have adopted the unitary method and thus apply their apportionment formula to income of a related group of corporations, the income of foreign affiliates of U.S. corporations is subject to apportionment if the activities of the foreign affiliates are dependent upon or contribute to the business of the corporation within the taxing State. These States thus treat income of foreign corporations related to U.S. corporations in the same manner as most States treat income of foreign branches of U.S. corporations.

Dividends of a foreign subsidiary are sometimes subject to State tax when received by a domestic corporation. In these cases the dividends are taxed in the same manner as dividends from domestic corporations (i.e., taxed by the State where the corporation is commercially domiciled or has its principal place of

business, added to the income subject to the apportionment formula of the taxing State, or, in some cases, taxed in both States). However, many States do not significantly tax any dividends from related corporations.

Previous attempts to modify present law. — As a result of court decisions in the late 1950s and early 1960s which expanded the constitutional limits of a State's jurisdiction to tax corporations with minimal levels of economic activity within the boundaries of that State, Federal legislation was enacted which required that a corporation at least accept and approve sales orders within any State before that corporation can be subjected to the income tax of that State. In more recent years, legislation mandating greater uniformity in the rules for State taxation of corporations has been introduced and studied. One such bill, which was reported by the House Judiciary Committee, passed the House in 1969 but was not enacted.

In 1969, a group of States reacted to the possibility of Federal legislation by adopting a multi-state tax compact, which established the Multistate Tax Commission whose duties are to establish uniform income tax regulations, auditing standards and tax forms for member States. Presently, 20 States are members of the compact (the majority of the States are Midwestern and Western States). Under the compact, the regulations of the Multistate Commission are effective in all member States, but any member State can adopt overriding regulations if they choose. Since most of these States have adopted some overriding regulations, the methods of taxing corporations still vary substantially among States which are members of the compact.

Issues

Although a larger controversy exists over the States' jurisdiction to tax income and the need for uniform rules among the States, the basic issue before the task force was whether the Federal Government should prohibit States (a) from taxing foreign source income directly, or (b) from taking into account foreign source income under the unitary method (as described above).

Alternatives

Limitations in applying the unitary method of apportionment. — States could be prohibited from requiring the reporting of income and related items of foreign corporations even though related to U.S. corporations which operate within that State. Under this proposal, the unitary method would not be applied either to foreign subsidiaries of U.S. corporations, to foreign parents of U.S. subsidiaries, or to other affiliated foreign corporations. This would not, however, prevent a State from taxing dividends paid by foreign subsidiaries, interest, or royalties received from foreign affiliates or other foreign sources, nor would it prevent the application of the three-factor formula to branch income from foreign operations of U.S. corporations operating in the State.

The reporting of income and related items of foreign corporations could be limited to activities of U.S. corporations which relate to exports from or imports to the United States, but the treatment of dividends, etc., could remain the same as above for income from other corporations.

The reporting of income and related items could be barred in the case of foreign-owned corporations with affiliates operating in any State, but allowed with respect to foreign subsidiaries of U.S.-owned corporations operating within the State (as would be done with U.K.-owned companies in the proposed convention between the United States and the United Kingdom). Dividends, etc., could remain taxable as above. Under this proposal, in the case of foreign-owned affiliated group of corporations, any State would be limited to applying its apportionment formula to the income of any member of the affiliated group operating within that State or other States.

Limitations on direct taxation of foreign source income. — States could be prohibited from directly taxing in any way foreign source income. This means they not only would not tax income through the unitary method, but also would not tax dividends from foreign subsidiaries, foreign source interest or royalties, or branch earnings of U.S. corporations. The States could also be prohibited from taxing foreign income of individuals.

States could be prohibited from taxing through the unitary method foreign affiliates not doing business in the State or from taxing dividends from foreign affiliates of U.S. companies, but allowed to tax interest or royalties or branch income.

Analysis

Limitations on the unitary method of apportionment. — For Federal income tax purposes, an apportionment formula is not used to divide income and costs between United States and foreign countries. Instead, income and costs are allocated between related companies using the criterion of what the costs and prices would be between these parties if they were independent parties dealing at arm's length (sec. 482). On the other hand, in computing what portion of the income of a single company is from foreign sources, an allocation of income and deductions approach is used (sec. 861). This approach already [p. 17430] produces significant problems when applied at the Federal level and would be virtually impossible to administer at the State level as applied to interstate transactions. Thus, there is no significant disagreement that the States must use some type of apportionment formula (as distinguished from making an allocation of income and deductions by separate accounting), since there would be no practical way of determining what income of a company is earned within a State as opposed to being earned within other States (or in foreign countries).

The rationale presented for using the unitary method to combine the business activities of related corporations which contribute to the business activities of a corporation within a taxing State is that the operations form an integrated business, and whether the business is conducted through a number of separate corporations or through one single corporation should not affect tax liability.

It is disputed whether those States applying the unitary method of taxing corporate business income under an apportionment formula do, in fact, tax the income of related foreign corporations. For example, under the three-factor apportionment formula, if it takes the same dollar amount of sales, the same value of property

and the same sized payroll to achieve a given level of income in the foreign subsidiary as it takes in U.S. operations, then no foreign income would be taxed by any State because the three factors would apportion the appropriate amount of income to foreign countries and to the State.

However, it is argued that in many countries abroad wages and property values are lower in proportion to income than in the United States. It is argued that, given these circumstances, the inclusion of foreign corporations under the unitary method of apportionment leads indirectly to State taxation of foreign source income by apportioning too much income to the United States. Whether or not this actually is the result in any specific case depends on whether the proportion of income to wages, property costs and sales in the specific country in which a corporation operates is higher than the proportion of the same items in the United States. In some cases, the unitary method operates to apportion more income to the United States than most people would agree should be so apportioned if each affiliate were treated as an independent entity operating on an arm's-length basis. However, in other cases the application of the unitary method may apportion less income to a State than would be apportioned under other acceptable methods.

An additional problem raised in relation to those States which have adopted the unitary method is the administrative burden which that method places on corporate taxpayers, particularly those which are foreign owned. For example, a corporation with one manufacturing plant in a unitary State has to obtain for that State's tax purposes the income, sales, property and payroll figures of all of its affiliates operating worldwide if the activities of those affiliates are dependent upon or contribute to the activities of the corporation within that State. In the case of a foreign parent corporation, this compliance burden could be particularly costly because a foreign-owned foreign corporation ordinarily would not otherwise keep the books of its operations outside of the United States in terms of U.S. dollars or in a manner which would conform to U.S. accounting concepts.

The need for applying the unitary method may not be as great when taking into account foreign source income than when taking

into account income from a number of States. The number of transactions in any State linked to foreign operations is ordinarily substantially fewer than the number of transactions linked to different States. Moreover, since taxpayers are in any event required to allocate income between U.S. and foreign sources for Federal income tax purposes, the States could adopt the Federal rules for apportioning income from foreign transactions between domestic and foreign sources.

Some critics of the unitary method of apportionment would nevertheless permit its use where the States can show that there is less than arm's length pricing in foreign transactions. If the unitary method were allowed only in this case, the State affected to the most substantial extent would be California. California State tax officials estimate that such a limitation would cost that State approximately $125 million in revenue, or about 12 percent of total corporate tax revenues.

It has also been suggested that the application of the unitary method could be limited to those cases where the business activities of the foreign subsidiary are related to exports from or imports into the United States. Export-related transactions generate the most difficult income allocation questions under the Federal tax rules, and thus it is suggested that it is appropriate to allow the States to decide whether Federal rules should be followed in those circumstances.

If the administrative burden which the unitary method causes taxpayers is viewed as the primary problem, the application of the unitary method to foreign corporations owned by foreigners could be prohibited.

Limitations on directly taxing dividends from foreign subsidaries —

Except as that result may be achieved indirectly under the unitary system, no State taxes the income of foreign subsidiaries (not doing business with the State) of U.S. corporations as that income is earned; that income is taxed only when it is remitted to a U.S. corporation as a dividend. In those States which tax foreign source dividends, it is argued that double taxation results because no credit is allowed for foreign taxes paid.

The Federal Government taxes dividends from foreign subsidiaries of U.S. corporations when they are brought back to the United States, but allows a foreign tax credit for foreign (national, state and local) income taxes paid by the subsidiary. Thus, to the extent that foreign income taxes do not exceed 48 percent of foreign taxable income, the tax burden on foreign source income also taxed by a State is no greater than the tax burden on domestic source income which is taxed by the Federal Government at 48 percent and by the State as well.

As in the case of State taxation of dividends from domestic corporations, the lack of uniform rules among the States does lead to over-taxation or under-taxation in various cases. If the taxation of dividends of foreign subsidiaries is prohibited, domestic source income in some cases will be taxed more heavily than foreign source income because all income taxes paid to local governments in foreign countries, as well as the income taxes paid their national governments, are creditable against U.S. Federal tax while income taxes paid to U.S., State and local governments are only deductible, and not creditable for Federal purposes.

Recommendations

The task force makes the following recommendations with respect to State taxation of foreign source income:

(1) *Income of foreign affiliates not subject to Federal income tax.* — It is recommended that the States be precluded from taking into account, under the unitary method or any other method, the income of foreign affiliates of corporations doing business within the States until such time as that income is subject to Federal income tax.

(2) *Income of foreign affiliates subject to Federal income tax.* — It is further recommended that no limitation be placed on the power of the States to apply the three-factor formula on a domestic basis, under the unitary method or otherwise, to income of foreign affiliates which had been excluded under paragraph (1) above if and when such income becomes subject to Federal income tax.

Mr. JAVITS. I yield 1 minute to the Senator from Alaska.

The PRESIDING OFFICER. The hour of 2 o'clock having arrived, the Senate will not proceed —

Mr. JAVITS. Mr. President, I ask unanimous consent that I may yield 1 minute to the Senator from Alaska.

The PRESIDING OFFICER. Without objection, it is so ordered. The Chair recognizes the Senator from Alaska.

Mr. STEVENS. Mr. President, last year when the United States-Korean Tax Treaty was pending on the calendar, several Senators expressed their concerns about article 10. This provision raised substantial issues regarding incentives which encourage the construction and operation of foreign-flag vessels and the provision's implication regarding traditional U.S. treaty response to this issue. The Secretary of the Treasury assuaged the Senators' concerns and expressed the Department's endorsement of a strong U.S. merchant marine fleet.

While the Secretary's response addressed the immediate concerns raised by this particular treaty, further questions remain unanswered. I find it disturbing that certain tax code provisions encourage flag of convenience shipping; possibly at the expense of the American maritime industry and the U.S. Treasury. Following are five sets of questions relating to these tax incentives which I would like the Treasury Department to investigate. Responsible congressional action in this area requires the availability of information on existing code provisions and their demonstrated effect on foreign-flag vessels. Attention to these questions will do much to aid Congress in its pursuit of tax provisions which are in the best national interest.

First, what U.S. tax mode provisions currently exist which encourage American shippers to register in a foreign country? How do these incentives change the proportion of U.S. owned and registered ships to flag of convenience vessels? What revenue effect is the result of this change?

Second. To what extent do these tax provisions affect the number of vessels built in U.S. shipyards? Assuming a reduction in American vessels built, what repercussions are there for employment, both in the shipbuilding industry and related industries,

such as steel? Do these losses represent a substantial reduction in revenues to the U.S. Treasury?

Third. Foreign flag shippers need not comply with U.S. laws and are therefore not required to abide by our labor laws nor our environmental safety standards. To what extent does this fact discourage the hiring of American labor and subsequently affect transfer payments from the U.S. Treasury: Does the escapement from U.S. environmental safety standards endanger our marine and coastal environments thus posing potential economic loss for both shipping concerns and the U.S. Treasury?

Fourth. Given that the flag of convenience vessels must abide by the shipping [p. 17431] requirements for the country in which the vessels are registered, to what extent are trade routes impacted? Is there an impact on the quantity or variety of goods shipped to or from the United States? Is there a revenue loss as a result?

Fifth. Does the use of foreign flag vessels influence our balance of payments?

It is my belief that encouragement of foreign flag vessels may be detrimental to the maintenance of a strong merchant fleet and may undermine efforts to deal with unemployment, environmental safety, and the trade deficit. A thorough study of the composite effects of this encouragement will be invaluable to Congress as we pursue legislation which is in our best national interest. I urge the committee to join with me in requesting answers to these questions.

United States-United Kingdom Tax Treaty

Mr. MORGAN. Mr. President, last summer, during the initial consideration of the United States-United Kingdom Tax Treaty, I advised my colleagues after the inclusion of the Church reservation, that by voting for that reservation they had placed themselves at the mercy of the British Parliament not to reconsider their own tax concessions to us and that we were thus relying on their good will which we were not willing to show ourselves. I forecast that this issue is far from closed and expressed that I had no doubt that this body will again be asked to deliberate a new tax

treaty with the United Kingdom, one which will unfortunately be less favorable than the version which was originally before us last summer.

Evidently, there is considerable concern among the members of the British Parliament concerning the use of the worldwide combined reporting system of taxation assessment.

I would ask unanimous consent that a copy of the Early Day Motion filed in the House of Commons on June 11, 1979, indicating the support of 59 members of the House of Commons, be printed in the RECORD in connection with the treaty. I understand that now more than 100 members of the House of Commons have expressed their support of that motion.

There being no objection, the motion was ordered to be printed in the RECORD, as follows:

DOUBLE TAXATION RELIEF TREATY BETWEEN THE UNITED STATES OF AMERICA AND THE UNITED KINGDOM

Mr. Geoffrey Rippon, Mr. William Clark, Mr. Peter Hordern, Mr. Michael Grylls, Mr. Roger Moate, Mr. Patrick McNair-Wilson, Mr. Peter Emery, Mr. Bentley Heddle, Mr. John Hunt, Mr. Mark Wolfson, Sir Anthony Meyer, Mr. Peter Rost, Mr. Robert Dunn, Mr. John Corrie.

Mr. Michael Ancram, Mr. Graham Bright, Mr. Eldon Griffiths, Mr. Christopher Murphy, Mr. John Stokes, Sir Nigel Fisher, Mr. Geoffrey Dodsworth, Mr. Charles Irving, Mr. Nicholas Winterton, Mr. Tom Normanton, Mr. Ian Grist.

Mr. Robert Rhodes James, Sir John Langford-Holt, Mr. David Price, Mr. Tim Rathbone, Mr. John Hannam, Mr. Hal Miller, Mr. Walter Clegg, Mr. Michael Shaw, Mr. A. P. Costain, Mr. Victor Goodhew, Mr. Malcolm Thornton, Mr. Michael Mates, Mr. John Loveridge, Mr. Jim Spicer, Mr. Michael Brown, Mr. Timothy Eggar, Mr. Ralph Howell.

Mr. Robert McCrindle, Mr. Sydney Chapman, Mr. John Selwyn Gummer, Mr. Keith Wickenden, Mr. Ivan Lawrence, Mrs. E. Kellett-Bowman, Mr. Keith Proctor, Mr. Michael Colvin,

Mr. R. Graham Page, Mr. John Ward, Mr. Richard Body, Mr. Barry Henderson, Mr. Ivor Stanbrook, Mr. Robert Atkins, Mr. John Spence, ★59, Mr. Alastair Goodlad, Mr. Charles Fletcher-Cooke.

That this House is of view that a vital feature of any relationship between the United States of America and the United Kingdom regarding relief from double taxation should be a clear understanding prohibiting the use of the worldwide combined reporting system in assessing the tax of corporations doing business in both countries, such as would have been accomplished by Article 9(4) of the original Double Taxation Relief Treaty between the United States of America and the United Kingdom; and urges Her Majesty's Government to do its utmost to ensure that any contrary arrangement be rectified so as to avoid a harmful international precedent and serious consequences for both British and United States companies with overseas interests.

Mr. MORGAN. Mr. President, it will note that they feel that a vital feature of any relationship between the United States of America and the United Kingdom regarding relief from double taxation should be a clear understanding prohibiting the use of the worldwide combined reporting system in assessing the tax of corporations doing business in both countries.

Ultimately, I would prefer to have the tax issue raised in a bill rather than a treaty so that both Houses would have an opportunity to discuss the fiscal implications of this issue. I understand that Senator MATHIAS has introduced S. 983, section 303 of which would seek to eliminate double taxation by prohibiting the use of a worldwide combined reporting system. It appears essential to the adoption of the treaty by Parliament that this bill receive a complete review. Until that occurs it still appears that this issue is far from closed.

★The figure following this symbol gives the total number of names of Members appended, including those names added in this edition of the Notices of Questions and Motions.

UNITED STATES-UNITED KINGDOM INCOME TAX TREATY

● Mr. PELL. Mr. President, it is with great satisfaction that I support the third protocol to the Income Tax Treaty between the United States and the United Kingdom. Even before the treaty itself was submitted to the Senate last year, I was active in support of the effort embodied in the second protocol to this treaty to correct a serios inequity affecting U.S. citizen women married to U.K. subjects residing in Britain. I have, therefore, a very direct and personal interest in this treaty.

Last year, I was the majority floor manager for this treaty, which received the advice and consent of the Senate subject to a reservation which had the effect of nullifying article 9(4). This article would have restricted the power of individual States to apply the "unitary method" of taxation of U.K. companies. I am pleased that the British Government agreed to renegotiate this provision in the form of the third protocol, as an up-to-date agreement on income taxes is important to individuals and corporations of both countries.

In last year's debate on article 9(4), a major argument advanced by the opponents of this article was that States employing the "unitary method" of taxation should not be forced to abandon that system of taxation with respect to United Kingdom corporations through a treaty. Instead, it was argued, the limited change provided for in article 9(4) should be addressed through legislation involving the House as well as the Senate. Thus, the senior Senator from Idaho, who sponsored the reservation on article 9(4), said at the time the Senate was considering the treaty that "article 9(4) could serve as a precedent for fashioning internal tax policy via agreements with foreign governments. As such, a new method will have been devised for obtaining legislation through the treaty process, circumventing the tax-writing committees of both the House and the Senate."

I am confident that the Senate will give its advice and consent to the third protocol that is before us today. I hope, therefore, that with the approval of this protocol, early consideration will take place of the kind of legislation on taxation methods that Senator CHURCH and other opponents of article 9(4) spoke of last year.

One such legislative approach is S. 983, sponsored by Senator MATHIAS. Other approaches may also be developed, but the important thing in my view is that with the approval of the third protocol, the Senate should take a close look at the "unitary method" of taxation as it relates to foreign corporations.●

UNITED STATES-UNITED KINGDOM TAX TREATY

● Mr. HUDDLESTON. Mr. President, earlier this month I had the opportunity to meet Michael Grylls, Member of the House of Commons. Mr. Grylls was in Washington to attend the hearing on the United States-United Kingdom tax treaty before the Senate Foreign Relations Committee. During our conversation Mr. Grylls made it plain to me that the British consider an ultimate resolution to the problem posed by the use by certain States of the worldwide combined reporting system method of tax assessment essential to any relationship regarding double taxation between the United Kingdom and the United States. He advised me that an early day motion had been filed in the House of Commons which clearly made that point.

I submit for the RECORD a copy of the statement of Michael Grylls, Member of the House of Commons, which was included in the testimony of Senateor MATHIAS before the Senate Foreign Relations Committee on June 6, 1979, concerning the United States-United Kingdom tax treaty. A copy of the early day motion is included in that statement.

The material follows:

STATEMENT OF MICHAEL GRYLLS MP, REGARDING THE DOUBLE TAXATION RELIEF TREATY BETWEEN THE UNITED STATES AND THE UNITED KINGDOM

I have been a Member of the House of Commons since 1970. As I was involved in private business prior to my first election I have been vitally interested in the relation of government and industry, both nationally and internationally. I am a member of the Conservative Commonwealth Council, a Fellow of [p. 17432] the Royal Institute of International Affairs, and have served as Vice-Chairman of the Conservative Industry Committee.

Thus, I followed the discussions in Parliament regarding this Treaty between the United States and the United Kingdom quite closely, with particular attention to the treatment in the Treaty of the use of the worldwide combined reporting systems in assessing the taxation of companies doing business in both countries, even elsewhere. When the House of Commons considered the Treaty on January 12, 1977, it was pointed out that no complaint was being made in England about reducing barriers to international investment and that the consequences of the Treaty, especially regarding remittances, looked far more favourable to the United States and its Internal Revenue Service, than to the United Kingdom.

Article 9(4) of the Treaty was considered to be an essential part. Its importance was due to the fact that it would put right the plainly wrong situation wherein certain states in the United States could impose taxes on companies not by virtue of their operation in a single state alone, but by the size of their operations throughout the world.

When we considered the Treaty we did so without the benefit of knowing how the United States Senate would treat the Treaty. That body subsequently removed Article 9(4). A third Protocol to that effect has resulted and is now before the United States Senate for ratification. Of course, if approved by the Senate, approval must also be obtained from Parliament.

There is substantial evidence that the absence of an Article 9(4) type prohibition in the Treaty will cause it to be subject to very close scrutiny and enlarged debate as we consider it in the House of Commons. The confederation of British industry, which is the leading representative body of British industry, both public and private, has recently written to the Chancellor of the Exchequer, Sir Geoffrey Howe, suggesting that the Treaty should not be adopted in its present form. The confederation pointed out to the Chancellor that the "combined reporting unitary system" of taxation leads to multiple taxation and in fact has been condemned by the Organization for Economic Co-operation and Development of which both the United States and the United Kingdom are members. I understand that the United States Supreme Court has in a recent decision also condemned taxation

by states upon instruments of foreign commerce when it results in double taxation or prevents the United States from speaking in one voice regarding such international activities.

The Chairman of the Bowater Corporation Limited, The Rt Hon Lord Erroll of Hale, in his statement contained in its 1978 Annual Report and Accounts, said that such taxation systems "if widely adopted, could cause groups of companies which operate internationally to suffer multiple taxation on their profits. This would clearly be both unjust and inimical to the proper flow of international investment".

A resolution has been placed before the International Chamber of Commerce which makes clear the need for one voice in matters on international taxation by political subdivisions and urges all possible measures be taken to ensure that the terms of an agreement or treaty dealing with taxation on income shall bind all authorities having jurisdiction within the boundaries of each contracting state.

Attached to this statement is a copy of an Early Day Motion which will be introduced in the House when it returns from recess on June 11, 1979. That motion reveals that prohibition of the use of the worldwide combined reporting systems of taxation assesment is essential to any United States-United Kingdom relationship regarding multiple taxation. Personally, I have been amazed at the short-sighted view taken by the Third Protocol and have marveled that my country and the United States which together have the largest numbers of multinational corporations in the world, and thus the most to lose from setting such a precedent, would negotiate such an open ended arrangement making available this practice of multiple taxation to other countries and their political subdivisions.

I have reviewed the hearings of the Senate Foreign Relations Committee regarding the Treaty and read the pages of the Congressional Record containing the debate concerning its ratification. I noticed an admission among those who expressed opposition to Article 9(4) that there was a problem caused by the unrestrained use of the worldwide combined reporting system and

that the proper avenue towards a solution was one of legislation which would be considered by both Houses of Congress.

I am aware that legislation has been introduced in the United States Senate sections of which address this problem. From my understanding of the recent United States Supreme Court decision it appears that if the Treaty does not deal with this problem, and the United States Congress otherwise fails to address it, then aggrieved companies will certainly be in a position to resort to the United States courts for relief though costly and time consuming.

British industry and Parliament shall be following with great interest the discussions of the Treaty by the Senate Foreign Relations Committee and the full Senate. Indications and assurance that the problems caused both the United States and the United Kingdom by the use of the worldwide combined reporting system are being rectified either in the Treaty or by legislation which will be passed by the United States Congress will be quite helpful in obtaining approval of any treaty submitted to Parliament for approval.

House of Commons,
London SWIA OAA.

Early Day Motion To Be Submitted to the House of Commons on 11th June 1979

That this House is of the view that a vital feature of any relationship between the United States of America and the United Kingdom regarding relief from double taxation should be a clear understanding prohibiting the use of the worldwide combined reporting system in assessing the tax of corporations doing business in both countries, such as would have been accomplished by Article 9(4) of the original Double Taxation Relief Treaty between the United States and the United Kingdom: and this House urges Her Majesty's Government to ensure that arrangements be made to rectify a harmful international precedent and serious consequences for both British and United States companies with overseas interests.●

● Mr. MATHIAS. Mr. President, I would like to make a few comments about the article 9(4) issue in the United Kingdom tax treaty, not to urge that the treaty be altered again, but rather to urge support for my effort to address the problem legislatively. I have introduced S. 983, the interstate taxation bill, and that bill, in section 303, would accomplish for all nations what our negotiators attempted to achieve in article 9(4) for the United Kingdom alone.

The legislative approach not only will resolve the problem across the board rather than on a treaty-by-treaty basis, but it will also answer the requests of those House Members who, during the Senate debate on the treaty, spoke with me about the possibility of substituting the bill for article 9(4), because a legislative approach would give them an opportunity to address the issues raised by the article.

Since the introduction of the bill, several events have taken place which should give increased impetus to such a legislative solution. The Supreme Court of the United States in the recent *Japan Line, Ltd.* v. *County of Los Angeles* case No. 77-1378, decided April 30, 1979, seems to be moving in the direction of ruling that the use of worldwide combined reporting system of taxation violates the commerce clause of the Constitution.

As indicated in the statement of Michael Grylls, Member of the House of Commons of Great Britain, which was included in my testimony before the Senate Foreign Relations Committee regarding the treaty, Parliament will not accept the treaty as it is now drafted unless it receives assurances that a legislative resolution of the problem is imminent. In fact, the Confederation of British Industry, which is the equivalent of the U.S. Chamber of Commerce, has recommended that the treaty be renegotiated if the legislation fails of passage. Also, an early day motion has been filed in Parliament and has, at last count, 100 supporters. That motion would express the sense of the House of Commons that the worldwide combined reporting system should be eliminated.

Of course, this problem concerns other countries and their relations with the United States and U.S. corporations. The United States must speak with one voice in its foreign relations,

and the Constitution requires that the Federal Government provide that voice. There is also the possibility that, if the United States continues to allow more than one voice in taxation of international enterprise, other countries and their political subdivisions will follow suit.

I would like to quote from page 6 of the report of the Committee on Foreign Relations on the third protocol to this treaty, June 15, 1979:

The [Foreign Relations] Committee urges the tax-writing committees of the Congress — the Finance and the Ways and Means Committees — to hold hearings in the very near future on S. 983 in order to permit all sides of the issue to have their views known for the record. In addition, such legislation will give the Congress, which has the responsibility to resolve on the federal level inconsistent state taxation policies, the opportunity to take a position on the merits of the issue.

Keeping these considerations in mind, I look forward to complete and adequate hearings on S. 983 in September so that we can move forward in solving this serious problem and furnish the British Parliament with sincere assurances that we understand and appreciate the gravity of the situation and are striving toward a solution.●

● Mr. GLENN. Mr. President, I supported the United States-United Kingdom tax treaty when it was considered by the Senate in June of 1978. During the consideration of that treaty in the Foreign Relations Committee, I also favored its approval without a reservation to article 9(4), a provision which would [p. 17433] have restricted the ability of a State to use the worldwide combined reporting system in assessing the State income tax liability of a United Kingdom corporation. That article, of course, was removed from the treaty by such a reservation.

The controversial feature of the worldwide combined reporting system is its extraterritoriality. The apportionment calculation under this unitary method of taxation is applied, not simply to the corporation which is doing business within the State, but also to affiliated corporations which may not be doing any business in the State, or in the United States for that matter. This extension of

State taxing power through the unitary method to foreign corporations not doing business in the State, or perhaps in the United States, could subject them to double taxation. That causes concern.

Since the Senate considered this matter in June of 1978, there have been developments of which we should be cognizant. A recent decision of the U.S. Supreme Court in the case of *Japan Line, Ltd.* v. *County of Los Angeles*, No. 77-1378, which was decided on April 30, 1979, has established that when a State seeks to tax the instrumentalities of foreign, rather than interstate, commerce, a court must first inquire whether the tax creates a substantial risk of international multiple taxation, regardless of apportionment. Second, that decision holds that the Court must inquire whether the tax prevents the Federal Government from "speaking with one voice when regulating commercial relations with foreign governments."

More recently, the Supreme Court has decided to hear an appeal brought by Mobil Oil Corp. from a decision of the supreme court of Vermont that deals with the issue of whether it is constitutional for a State to tax dividends from foreign subsidiaries and investments received by corporations that are not based in the State.

Also, Senator MATHIAS has introduced a bill, S. 983, which provides in its section 303 for a prohibition against the use of the worldwide combined reporting system by States in assessing the tax of corporations doing business in more than one country. I feel that the Senate should give its fullest consideration to this issue, given the recent history of Supreme Court actions.●

UNITED STATES-UNITED KINGDOM TAX TREATY

Mr. PERCY. Mr. President, the Senate is today voting on the third protocol to the United States-United Kingdom tax treaty. When the treaty itself was considered by the Senate a year ago, a reservation was adopted which removed article 9(4) dealing with the use of unitary taxation formulas by the individual States. I regretted and spoke against that action at the time.

The unitary taxation issue is still very much with us however, and an indication of Congress intent to deal equitably with it is key to the final ratification of the treaty by the United Kingdom.

A legislation solution to this issue is pending before the Congress and strong interest in it has been expressed by Members in both Houses. This measure, section 303 of S. 983, introduced by Senator MATHIAS, prohibits the use of the worldwide combined reporting system by the States. States would thus be required to utilize the same method of taxing multinational corporations as that utilized by the Federal Government. This change is considerably more equitable than the unitary systems now employed by a very few States and will, in my opinion, prove to be more beneficial to the economies of the States than continued or expanded use of the unitary system would be.

I understand that the Finance Committee intends to hold hearings on S. 983 and I urge my colleagues there to act expeditiously on section 303.

ESTATE AND GIFT TAX TREATY WITH THE FRENCH REPUBLIC

The PRESIDING OFFICER. The resolutions of ratification of all six protocols, conventions, and treaties having been read, the Senate will proceed to vote on the first treaty, the estate and gift tax treaty with the French Republic.

The resolution of ratification of Executive J, 96th Congress, 1st session, was read as follows:

Resolved (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the Convention Between the United States of America and the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates. Inheritances and Gifts, done at Washington on November 24, 1978 (Ex. J, Ninety-sixth Congress, first session).

The PRESIDING OFFICER. (Mr. PRYOR). The question is on agreeing to the resolution of ratification of Executive J, 96th Congress, 1st session, the Estate and Gift Tax Treaty with the French Republic.

On this question the yeas and nays have been ordered, and the clerk will call the roll.

The second assistant legislative clerk called the roll.

Mr. STEVENS. I announce that the Senator from Oregon (Mr. PACKWOOD) and the Senator from South Dakota (Mr. PRESSLER) are necessarily absent.

The PRESIDING OFFICER. Are there any other Senators wishing to vote?

The yeas and nays resulted — yeas 98, nays 0, as follows:

[Rollcall Vote No. 154 Ex.]

YEAS — 98

Armstrong	Domenici
Baker	Durenberger
Baucus	Durkin
Bayh	Eagleton
Bellmon	Exon
Bentsen	Ford
Biden	Garn
Boren	Glenn
Boschwitz	Goldwater
Bradley	Gravel
Bumpers	Hart
Burdick	Hatch
Byrd, Harry F., Jr.	Hatfield
Byrd, Robert C.	Hayakawa
Cannon	Heflin
Chafee	Heinz
Chiles	Helms
Church	Hollings
Cochran	Huddleston
Cohen	Humphrey
Cranston	Inouye
Culver	Jackson
Danforth	Javits
DeConcini	Jepsen
Dole	Johnston

Kassebaum
Kennedy
Laxalt
Leahy
Levin
Long
Lugar
Magnuson
Mathias
Matsunaga
McClure
McGovern
Melcher
Metzenbaum
Morgan
Moynihan
Muskie
Nelson
Nunn
Pell
Percy
Proxmire
Pryor
Randolph
Ribicoff
Riegle
Roth
Sarbanes
Sasser
Schmitt
Schweiker
Simpson
Stafford
Stennis
Stevens
Stevenson
Stewart
Stone
Talmadge
Thurmond
Tower
Tsongas
Wallop
Warner
Weicker
Williams
Young
Zorinsky

NAYS — 0

NOT VOTING — 2

PACKWOOD PRESSLER

The PRESIDING OFFICER. Two-thirds of the Senators present and voting having voted in the affirmative, the resolution of ratification is agreed to.

Mr. CHURCH. Mr. President, I move to reconsider the vote by which the resolution of ratification was agreed to.

Mr. JAVITS. I move to lay that motion on the table.

The motion to lay on the table was agreed to.

PROTOCOL TO THE INCOME TAX CONVENTION WITH THE FRENCH REPUBLIC

The resolution of ratification of Executive K was read as follows:

Resolved, (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the 1978 Tax Protocol with the French Republic together with an exchange of notes relating thereto, done at Washington on November 24, 1978 (Ex. K, Ninety-sixth Congress, first session).

The PRESIDING OFFICER. The question is on agreeing to the resolution of ratification of Executive K, 96th Congress, first session, the protocol to the Income Tax Convention with the French Republic. On this question the yeas and nays have been ordered, and the clerk will call the roll.

The second assistant legislative clerk called the roll.

Mr. STEVENS. I announce that the Senator from Oregon (Mr. PACKWOOD) and the Senator from South Dakota (Mr. PRESSLER) are necessarily absent.

The PRESIDING OFFICER. Are there any other Senators wishing to vote?

The yeas and nays resulted — yeas 98, nays 0, as follows:

[Rollcall Vote No. 155 Ex.]

YEAS — 98

Armstrong
Baker
Baucus
Bayh
Bellmon
Bentsen
Biden
Boren
Boschwitz
Bradley
Bumpers
Burdick
Byrd, Harry F., Jr.
Byrd, Robert C.
Cannon
Chafee
Chiles
Church
Cochran
Cohen
Cranston
Culver

Danforth
DeConcini
Dole
Domenici
Durenberger
Durkin
Eagleton
Exon
Ford
Garn
Glenn
Goldwater
Gravel
Hart
Hatch
Hatfield
Hayakawa
Heflin
Heinz
Helms
Hollings
Huddleston
Humphrey
Inouye
Jackson
Javits
Jepsen
Johnston
Kassebaum
Kennedy
Laxalt
Leahy
Levin
Long
Lugar
Magnuson
Mathias
Matsunaga
McClure
McGovern
Melcher
Metzenbaum
Morgan
Moynihan
Muskie
Nelson
Nunn
Pell
Percy
Proxmire
Pryor
Randolph
Ribicoff
Riegle
Roth
Sarbanes
Sasser
Schmitt
Schweiker
Simpson
Stafford
Stennis
Stevens
Stevenson
Stewart
Stone
Talmadge
Thurmond
Tower
Tsongas
Wallop
Warner
Weicker
Williams
Young
Zorinsky

[p. 17434] NAYS — 0

NOT VOTING — 2

PACKWOOD PRESSLER

The PRESIDING OFFICER. Two-thirds of the Senators present and voting having voted in the affirmative, the resolution of ratification is agreed to.

Mr. CHURCH. Mr. President, I move to reconsider the vote by which the resolution of ratification was agreed to.

Mr. JAVITS. I move to lay that motion on the table.

The motion to lay on the table was agreed to.

THIRD PROTOCOL TO THE 1975 TAX CONVENTION WITH THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND, AS AMENDED

The resolution of ratification of Executive Q was read as follows:

Resolved (two-thirds of the Senators present concurring therein). That the Senate advise and consent to the ratification of the 1979 Tax Protocol with the United Kingdom of Great Britain and Northern Ireland, done at London on March 15, 1979 (Ex. Q, Ninety-sixth Congress, first session).

The PRESIDING OFFICER. The question is on agreeing to the resolution of ratification on Executive Q, 96th Congress, first session, the third protocol to the 1975 Tax Convention with the United Kingdom of Great Britain and Northern Ireland, as amended. On this question the yeas and nays have been ordered, and clerk will call the roll.

The second assistant legislative clerk called the roll.

Mr. STEVENS. I announce that the Senator from Oregon (Mr. PACKWOOD) and the Senator from South Dakota (Mr. PRESSLER) are necessarily absent.

The PRESIDING OFFICER. Are there any other Senators wishing to vote?

The yeas and nays resulted — 98, nays 0, as follows:

[Rollcall Vote No. 156 Ex.]

YEAS — 98

Armstrong	Hart
Baker	Hatch
Baucus	Hatfield
Bayh	Hayakawa
Bellmon	Heflin
Bentsen	Heinz
Biden	Helms
Boren	Hollings
Boschwitz	Huddleston
Bradley	Humphrey
Bumpers	Inouye
Burdick	Jackson
Byrd, Harry F., Jr.	Javits
Byrd, Robert C.	Jepsen
Cannon	Johnston
Chafee	Kassebaum
Chiles	Kennedy
Church	Laxalt
Cochran	Leahy
Cohen	Levin
Cranston	Long
Culver	Lugar
Danforth	Magnuson
DeConcini	Mathias
Dole	Matsunaga
Domenici	McClure
Durenberger	McGovern
Durkin	Melcher
Eagleton	Metzenbaum
Exon	Morgan
Ford	Moynihan
Garn	Muskie
Glenn	Nelson
Goldwater	Nunn
Gravel	Pell

Percy	Stevens
Proxmire	Stevenson
Pryor	Stewart
Randolph	Stone
Ribicoff	Talmadge
Riegle	Thurmond
Roth	Tower
Sarbanes	Tsongas
Sasser	Wallop
Schmitt	Warner
Schweiker	Welcker
Simpson	Williams
Stafford	Young
Stennis	Zorinsky

NAYS — 0

NOT VOTING — 2

PACKWOOD PRESSLER

The PRESIDING OFFICER. Two-thirds of the Senators present and voting having voted in the affirmative, the resolution of ratification is agreed to.

Mr. CHURCH. Mr. President, I move to reconsider the vote by which the resolution of ratification was agreed to.

Mr. JAVITS. I move to lay that motion on the table.

The motion to lay on the table was agreed to.

ESTATE AND GIFT TAX TREATY WITH THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND

The resolution of ratification of Executive R was read as follows:

Resolved (two-thirds of the Senators present concurring therein). That the Senate advise and consent to the ratification of the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes

on Estates of Deceased Persons and on Gifts, done at London on October 19, 1978 (Ex. R, Ninety-sixth Congress, first session).

The PRESIDING OFFICER. The question is on agreeing to the resolution of ratification on Executive R, 96th Congress, first session, the Estate and Gift Treaty with the United Kingdom of Great Britain and Northern Ireland. On this question the yeas and nays have been ordered, and the clerk will call the roll.

The second assistant legislative clerk called the roll.

Mr. STEVENS. I announce that the Senator from Oregon (Mr. PACKWOOD) and the Senator from South Dakota (Mr. PRESSLER) are necessarily absent.

The PRESIDING OFFICER. Are there any other Senators wishing to vote?

The yeas and nays resulted — yeas 98, nays 0, as follows:

[Rollcall Vote No. 157 Ex.]

YEAS — 98

Armstrong
Baker
Baucus
Bayh
Bellmon
Bentsen
Biden
Boren
Boschwitz
Bradley
Bumpers
Burdick
Byrd, Harry F., Jr.
Byrd, Robert C.
Cannon
Chafee
Chiles
Church
Cochran
Cohen
Cranston
Culver
Danforth
DeConcini
Dole
Domenici
Durenberger
Durkin
Eagleton
Exon
Ford
Garn
Glenn
Goldwater
Gravel
Hart
Hatch
Hatfield

Hayakawa
Heflin
Heinz
Helms
Hollings
Huddleston
Humphrey
Inouye
Jackson
Javits
Jepsen
Johnston
Kassebaum
Kennedy
Laxalt
Leahy
Levin
Long
Lugar
Magnuson
Mathias
Matsunaga
McClure
McGovern
Melcher
Metzenbaum
Morgan
Moynihan
Muskie
Nelson
Nunn
Pell
Percy
Proxmire
Pryor
Randolph
Ribicoff
Riegle
Roth
Sarbanes
Sasser
Schmitt
Schweiker
Simpson
Stafford
Stennis
Stevens
Stevenson
Stewart
Stone
Talmadge
Thurmond
Tower
Tsongas
Wallop
Warner
Welcker
Williams
Young
Zorinsky

NAYS — 0

NOT VOTING — 2

PACKWOOD PRESSLER

The PRESIDING OFFICER. Two-thirds of the Senators present and voting having voted in the affirmative, the resolution of ratification is agreed to.

Mr. CHURCH. Mr. President, I move to reconsider the vote by which the resolution of ratification was agreed to.

Mr. JAVITS. I move to lay that motion on the table.

The motion to lay on the table was agreed to.

TAX CONVENTION WITH THE REPUBLIC OF KOREA

The resolution of ratification of Executive P was read as follows:

Resolved (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the 1976 Tax Convention with the Republic of Korea, together with an exchange of notes relating thereto, signed at Seoul on June 4, 1976 (Executive P, Ninety-fourth Congress, second session).

The PRESIDING OFFICER. The question is on agreeing to the resolution of ratification on Executive P, 94th Congress, 2d session, the Tax Convention with the Republic of Korea. On this question the yeas and nays have been ordered, and the clerk will call the roll.

The second assistant legislative clerk called the roll.

Mr. STEVENS. I announce that the Senator from Oregon (Mr. PACKWOOD) and the Senator from South Dakota (Mr. PRESSLER) are necessarily absent.

The PRESIDING OFFICER. Are there any other Senators wishing to vote?

The yeas and nays resulted — yeas 98, nays 0, as follows:

[Rollcall Vote No. 158 Ex.]

YEAS — 98

Armstrong
Baker
Baucus
Bayh
Bellmon
Bentsen
Biden
Boren
Boschwitz
Bradley
Bumpers
Burdick

Byrd, Harry F., Jr.
Byrd, Robert C.
Cannon
Chafee
Chiles
Church
Cochran
Cohen
Cranston
Culver
Danforth
DeConcini
Dole
Domenici
Durenberger
Durkin
Eagleton
Exon
Ford
Garn
Glenn
Goldwater
Gravel
Hart
Hatch
Hatfield
Hayakawa
Heflin
Heinz
Helms
Hollings
Huddleston
Humphrey
Inouye
Jackson
Javits
Jepsen
Johnston
Kassebaum
Kennedy
Laxalt
Leahy
Levin
Long
Lugar
Magnuson
Mathias
Matsunaga
McClure
McGovern
Melcher
Metzenbaum
Morgan
Moynihan
Muskie
Nelson
Nunn
Pell
Percy
Proxmire
Pryor
Randolph
Ribicoff
Riegle
Roth
Sarbanes
Sasser
Schmitt
Schweiker
Simpson
Stafford
Stennis
Stevens
Stevenson
Stewart
Stone
Talmadge
Thurmond

Tower
Tsongas
Wallop
Warner
Welcker
Williams
Young
Zorinsky

NAYS — 0

NOT VOTING — 2

PACKWOOD PRESSLER

The PRESIDING OFFICER. Two-thirds of the Senators present and voting having voted in the affirmative, the resolution of ratification is agreed to.

Mr. CHURCH. Mr. President, I move to reconsider the vote by which the resolution of ratification was agreed to.

Mr. JAVITS. I move to lay that motion on the table.

[p. 17435] The motion to lay on the table was agreed to.

TAX CONVENTION WITH THE HUNGARIAN PEOPLE'S REPUBLIC

The resolution of ratification of Executive X was read as follows:

Resolved (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the Convention Between the Government of the United States of America and the Government of the Hungarian People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, together with an exchange of notes relating thereto, done at Washington on February 12, 1979 (Ex. X, Ninety-sixth Congress, first session).

The PRESIDING OFFICER. The question is on agreeing to the resolution of ratification on Executive X, 96th Congress, 1st session, the Tax Convention with the Hungarian People's Republic. On this question the yeas and nays have been ordered, and the clerk will call the roll.

The second assistant legislative clerk called the roll.

Mr. STEVENS. I announce that the Senator from Oregon (Mr. PACKWOOD) and the Senator from South Dakota (Mr. PRESSLER) are necessarily absent.

The PRESIDING OFFICER. Are there any other Senators wishing to vote?

The yeas and nays resulted — 98 yeas, nays 0, as follows:

[Rollcall Vote No. 159 Ex.]

YEAS — 98

Armstrong
Baker
Baucus
Bayh
Bellmon
Bentsen
Biden
Boren
Boschwitz
Bradley
Bumpers
Burdick
Byrd, Harry F., Jr.
Byrd, Robert C.
Cannon
Chafee
Chiles
Church
Cochran
Cohen
Cranston
Culver
Danforth
DeConcini
Dole
Domenici
Durenberger
Durkin
Eagleton
Exon
Ford
Garn
Glenn
Goldwater
Gravel
Hart
Hatch
Hatfield
Hayakawa
Heflin
Heinz
Helms
Hollings
Huddleston
Humphrey
Inouye
Jackson
Javits
Jepsen
Johnston
Kassebaum
Kennedy
Laxalt
Leahy
Levin
Long
Lugar
Magnuson

Mathias	Sasser
Matsunaga	Schmitt
McClure	Schweiker
McGovern	Simpson
Melcher	Stafford
Metzenbaum	Stennis
Morgan	Stevens
Moynihan	Stevenson
Muskie	Stewart
Nelson	Stone
Nunn	Talmadge
Pell	Thurmond
Percy	Tower
Proxmire	Tsongas
Pryor	Wallop
Randolph	Warner
Ribicoff	Welcker
Riegle	Williams
Roth	Young
Sarbanes	Zorinsky

NAYS — 0

NOT VOTING — 2

PACKWOOD PRESSLER

The PRESIDING OFFICER. Two-thirds of the Senators present and voting having voted in the affirmative, the resolution of ratification is agreed to.

Mr. CHURCH. Mr. President, I move to reconsider the vote by which the resolution of ratification was agreed to.

Mr. JAVITS. I move to lay that motion on the table.

The motion to lay on the table was agreed to.

Mr. CHURCH. Mr. President, I move that the President be immediately notified.

The PRESIDING OFFICER. Without objection, it is so ordered.

* * *

[p. 17796] UNITED STATES-UNITED KINGDOM TAX TREATY

• Mr. HAYAKAWA. Mr. President, as indicated last June 1978, I favored the United States-United Kingdom Tax Treaty with article 9(4) included, because I am opposed to the application of combined reporting to multinational corporations. When applied in a multi-corporate setting, the doctrine of combined reporting requires that a corporation with a business location in the States include in its apportionable tax base not only the entire income of such corporations within the State, but also the income of such of its worldwide affiliates as are found by the State to participate with the corporation in a single business unit. This broad approach to corporation taxation by a State of the income of corporations that have no real contact or connection with the State can result in more than 100 percent of a company's income being subjected to State taxation or can result in a company paying that or an allocable portion of the entire income of another corporation, even though there is not complete unity of ownership between the two corporations. I also feel that such taxation doctrine impinges on the foreign relations of the United States.

During our deliberations concerning this treaty last summer, much was said about legislatively involving both Houses of Congress. Now that we have removed article 9(4) from the treaty we have an opportunity as provided by section ??? of Senator MATHIAS' Interstate Taxation Act, S. 983, to address the situation legislatively and I am glad that we did yesterday with the deliberation.•

EXHIBIT 36C

UNITED STATES OF AMERICA
Congressional Record

PROCEEDINGS AND DEBATES OF THE 95TH CONGRESS
SECOND SESSION

VOLUME 124 — PART 14

JUNE 15, 1978 TO JUNE 26, 1978

(PAGES 17731 TO 19072)

UNITED STATES GOVERNMENT PRINTING OFFICE,
WASHINGTON, 1978

* * *

[p. 18402] TAX CONVENTION WITH THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND — EXECUTIVE K. 94TH CONGRESS, 2D SESSION.

The Senate continued with the consideration of the treaty.

Mr. SPARKMAN. Mr. President, I ask unanimous consent that the United Kingdom-United States Treaty be considered as having passed through its various parliamentary stages up to and including the presentation of the resolution of ratification.

The PRESIDING OFFICER. Without objection, it is so ordered. The clerk will state the resolution of ratification.

The legislative clerk read as follows:

Resolved. (two-thirds of the Senators present concurring therein). That the Senate advise and consent to the ratification of the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed at London on December 31, 1975, and an Exchange of Notes signed at London on April 13, 1976, modifying certain provisions of the Convention (Executive K, 94th Congress, second session), and by two protocols, signed on August 26, 1976 (Executive Q, 94th Congress, second session) and on March 31, 1977 (Executive J, 95th Congress, first session).

* * *

Mr. SPARKMAN. Mr. President, I am pleased to present to the Senate the proposed United States-United Kingdom Income Tax Treaty, as amended by an exchange of notes and two protocols. On March 15, 1978, the Committee on Foreign Relations recommended that the Senate give its advice and consent to the treaty and the protocols.

The proposed treaty is intended to replace the existing treaty which was originally signed in 1945. The British House of Commons has already approved the new treaty and protocols. The treaty properly reflects the significance of our close and extensive economic relations with the United Kingdom and is designed to update existing arrangements.

In keeping with other income tax treaties, the proposed treaty contains basic provisions that are designed to avoid double taxation and to prevent evasion of income taxes. However, the treaty breaks new ground in several fundamental respects.

The agreement to refund the United Kingdom advanced corporation tax represents a major concession by the British. Under the new British system of integrated taxation, a tax, known as the A.C.T., is imposed upon divided payments of United Kingdom

corporations. The tax is then refunded to British shareholders, but not to other foreign shareholders.

This treaty proposes that U.S. shareholders be given a similar refund, thus eliminating the current discrimination against U.S. investors. The Joint Committee on Taxation has estimated that the refund of this tax will return approximately $375 million to individual and corporate U.S. investors for the years 1973-78, and approximately $90 million a year thereafter. In short, the refund of the tax will provide substantial rebates to American investors and create new investment incentives for our investors. In addition, the treaty commits the United States to reduce its withholding tax rates on dividends paid by American corporations to British investors.

A second new provision of the proposed treaty, contained in article 9(4), seeks to limit the application of the unitary apportionment method in assessing the State income tax liability of any corporation that is controlled by British investors. The proposed treaty provides that a State may not take into account the operations of any affiliated corporation that is not doing business in that State. Rather, the States will be empowered only to utilize the arm's length method, a formula used by the Federal Government and many foreign governments.

* * *

[p. 18403] In most other areas, the proposed treaty is substantially similar to the existing tax treaty with the United Kingdom to other recent U.S. tax treaties and to the model tax treaty of the organization for economic cooperation and development

The proposed tax treaty is vitally important in furthering the objectives of our international economic policies. These objectives are concerned with the removal of impediments to the free international flow of capital and technology, the prevention of tax evasion, and removal of differential tax rates that discriminate against American investors. Of particular significance, the treaty provides for substantial economic refunds to American investors. In a major concession, the British have agreed to make these refunds retroactive, which will immediately provide $375 million

to our investors for the years 1973 through 1978, and $90 million per year thereafter.

* * *

The United Kingdom is one of our major trading partners with whom we have shared close economic relations for many years. Vast changes have occurred in this relationship since 1945, when the existing treaty was first signed. The treaty serves to update outmoded tax laws and institute internationally recognized standards in the area of tax administration. The arm's length method in article 9(4) is one such uniformly accepted standard and thus simplifies the administrative complexities in the determination of taxable income of United Kingdom corporations.

* * *

Mr. President, I ask unanimous consent that excerpts from the committee report be printed in the RECORD at this point.

There being no objection, the excerpts were ordered to be printed in the RECORD, as follows:

INCOME TAX TREATY WITH THE UNITED KINGDOM AND TWO PROTOCOLS REPORT

* * *

II. BACKGROUND

The proposed Tax Treaty with the United Kingdom was signed on December 31, 1975, and was amended by the Exchange of Notes (signed on April 13, 1976), the first Protocol (signed August 26, 1976) and the second Protocol (signed on March 31, 1977). The Tax Treaty and the Exchange of Notes were transmitted to the Senate on June 24, 1976.

The proposed Tax Treaty, as amended by the Exchange of Notes and the two Protocols, has been approved by the United Kingdom House of Commons.

III. Summary of Treaty

The proposed treaty is substantially similar to the existing tax treaty with the United Kingdom, to other recent U.S. tax treaties, and to the model tax treaty of the Organization for Economic Cooperation and Development (OECD). There are, however, several provisions of the proposed treaty which are not found in other U.S. tax treaties. Of particular significance are the new provisions contained in the proposed treaty (1) which provide for a refund by the U.K. to U.S. portfolio and direct shareholders receiving dividends from British corporations of Advance Corporation Tax (ACT) paid by the distributing corporation (*Article 10*) and allow a U.S. foreign tax credit for the one-half of the ACT which is not refunded to U.S. direct corporate investors (*Article 23*), (2) which limit the right of states to apportion income of British multinational corporations under the unitary method (*Article 9(4)*), and (3) which treat the British Petroleum Revenue Tax (PRT) as a creditable tax for U.S. foreign tax credit purposes (*Articles 2 and 23*).

IV. Provisions of Treaty

* * *

Article 5. Permanent establishment

Article 5 defines the term permanent establishment for purposes of the treaty. The manner in which income of a resident of one country is taxed by the other country is generally dependent upon whether the income [p. 18404] is attributable to a permanent establishment which the resident has in that other country.

* * *

Article 7. Business profits

Article 7 defines the term "business profits" and provides the general rule that residents of one country are not to be taxed on business profits from the other country unless they are attributable to a permanent establishment in that other country.

* * *

Article 9. Associated enterprises

Article 9 sets forth the right of each country to allocate income on an arm's-length basis in the case of transactions between related persons.

Article 9(4). State taxation/unitary method

The proposed treaty contains a new provision, not fund in other United States tax treaties, which places limitations on the combined reporting method used by several states of the United States to determine the taxable income which multinational corporations derive from sources within the state. Under this apportionment method, the operations of all related corporations (both domestic and foreign) are taken into account on a consolidated basis. The proposed treaty provides generally that in determining the tax liability of a British corporation doing business within a state, or of any subsidiary (U.S. or foreign) doing business within a state which is controlled by a British corporation, the state may not use the combined reporting method to take into account the operations of any related foreign corporation which is not doing business within the state. In such cases, the arm's-length method may be applied.

* * *

[p. 18405] VII. Committee Action

The Committee considered the proposed treaty on March 15, 1978, and ordered it favorably reported by a voice vote with the recommendation that the Senate give its advice and consent to ratification of the proposed treaty. Prior to the vote. Senator Church proposed that a reservation be attached to the provision that restricts the use of the unitary taxing method. Article 9(4). The proposed reservation on Article 9(4) was defeated by a vote of 10 to 5. The Senators favoring a reservation were Senators Church, Clark, Humphrey, Sarbanes, and Sparkman. The Senators opposing a reservation were Senators Baker, Case, Glenn, Griffin, Javits, McGovern, Pearson, Pell, Percy, and Stone.

* * *

[p. 18408] *Article 9. Associated enterprises*

The proposed treaty, like most other U.S. tax treaties, contains a provision similar to that contained in the Internal Revenue Code (sec. 482) which recognizes the right of each country to make an allocation of income in the case of transactions between related persons. If an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons.

It is anticipated that when a redetermination has been made by one country with respect to the income of a related person, the other country will attempt to reach an agreement with the first country in connection with the redetermination, and if it agrees with the redetermination, it will make a corresponding adjustment to the income of the other person.

Limitation on State Taxation

The proposed treaty also containes a new provision, not found in other United States treaties, which limits the methods by which the United States, the United Kingdom, and political subdivisions and local authorities of each country may tax enterprises of the other country (or enterprises which are directly or indirectly controlled by enterprises of the other county). The proposed treaty provides that in determining the tax liability of such an enterprise doing business within their respective jurisdictions, the United States, the United Kingdom and their political subdivisions and local authorities may not take into account the income, deductions, receipts or outgoings of a related enterprise of the other country or of any third country.

Background.—This provision applies to those states of the United States which, in determining the amount of income of a business operating within the state which is to be apportioned to that state for income tax purposes, require combined reporting of all related business operations (including related business operations of affiliated U.S. and foreign corporations, whether or not doing business within the state). The governments of the United Kingdom and the United States do not apportion income between jurisdictions under this method but rather allocate income between relaed enterprises under arm's-length principles as specified in other paragraphs of this article. In addition, the political subdivisions and local authorities of the United Kingdom do not impose income taxes. Consequently, this provision's only application is to limit the combined reporting method used by certain states of the United States.

In determining what business income of a corporation is earned within a state and thus subject to income tax by that state, all states imposing an income tax use some type of apportionment system. An apportionment system is necessary because of the difficulties of attempting to account separately for business income in any state where the activities of a single business are carried on beyond the borders of that one state. In most states this business income is apportioned between the state and other jurisdictions according to a basic three-factor formula (or some variation of the formula) under which total business income is multiplied by the average ratio of sales, payroll, and property values within the state to total sales, payroll, and property values associated with the business. This type of apportionment, when applied to a single business of one corporation, is called the "unitary method" of apportionment and is used by most states which have a corporate income tax. The proposed treaty does not affect the application of this method when applied to a single corporation.

However, some states have adopted "combined reporting" requirements, which extend the unitary method to corporations related to the corporation doing business within the state (subsidiaries, parent corporations, or brother-sister corporations), whether or not these related corporations are doing business within the state, where the activities of the related corporations are considered by the state to constitute a unitary business. For example, if a U.K. manufacturing company operating in a state requiring combined reporting owns a U.S. subsidiary which sells the products manufactured by the U.K. parent, the income subject to tax in that state would be determined under the combined reporting method by applying the average ratio of the sales, payroll, and property values in the state to total sales, payroll, and property values of both corproations in both countries

and multiplying these average ratios against the combined worldwide income of the two corporations.

California, Oregon, and Alaska are the primary states requiring the use of combined reporting in connection with related foreign corporations as well as related domestic corporations. Certain other state governments have also indicated that combined reporting with respect to related foreign corporations is at times required in their states, or that they may in the future require this type of reporting at least in some cases.

Explanation of limitation—The treaty provision prevents a state from extending the unitary method through this combined reporting system to related foreign enterprises where the enterprise doing business in the state is either a British enterprise or is controlled directly or indirectly by a British enterprise. Thus, for example, if a U.S. branch of a British corporation does business in a state, that state cannot apply the unitary method to combine the income (and sales, payroll, and property) of any related foreign enterprises (from the United Kingdom or any third country) with those of that British corporation in determining the income of its U.S. branch which is taxable by that state. However, that state may take into account the income and assets of any other branches of that corporation wherever located, because a corporation is considered to be a single enterprise regardless of how many separate branches or businesses it has. Alternatively, if the British corporation does not do business in the state but has a U.S. subsidiary (or any other corporation which it directly or indirectly controls) doing business in the state, that state, in determining the taxable income of that U.S. subsidiary, cannot apply combined reporting requirements to include the income (and the sales, payroll, and property values) of the British parent corporation or other related foreign enterprises. Of course, in either situation described above the state may take into account the income and assets of any related U.S. corporations.

The limitation in Article 9(4) applies only to cases where an apportionment formula is used without regard to any application of the arm's-length standard (provided under *Article 9(1)*). Of course, both countries and their political subdivisions may apply apportionment formulas, including formulas that take into account attributes of related entities, as a method of achieving an arm's-length price for a transaction between related entities. Moreover, apportionment formulas may be used as a method of apportioning income of related entities to the extent that it is established that they are not dealing on an arm's length basis.

There are two additional exceptions to the combined reporting limitation. First, if the British enterprise is a corporation which is itself directly or indirectly controlled by residents of the United States (Code sec. 957) or of any third country, the limitation does not apply. In addition, in computing the tax liability of any U.S. subsidiary (or other enterprise) resident in the state which is controlled by a British enterprise, the three factor formula may, notwithstanding the general prohibition, be applied to any related foreign enterprise to the extent that the U.S. subsidiary owns, directly or indirectly, the capital of the related foreign enterprise.

For purposes of the proposed treaty, an enterprise is related to another enterprise if either enterprise directly or indirectly controls the other, or if any third person or persons (related to each other or acting together) control both. The term control is not limited to the ownership of the capital of an enterprise, and it includes any kind of control, whether or not legally enforceable, however exercised or exercisable.

* * *

[p. 18415] Mr. SPARKMAN. Mr. President, I am in unanimous consent that an editorial [p. 18416] from the Wall Street Journal and an editorial from the New York Times be printed in the RECORD.

There being no objection, the material was ordered to be printed in the RECORD as follows:

[From the Wall Street Journal, May 10, 1978]

NOW, THE U.K. TAX TREATY

Out of the corner of your eye, no doubt, you have been seeing stories and commentaries about the tax treaty our State Department negotiated with the United Kingdom. In the next day or so, most likely, the U.S. Senate will vote the treaty up or down. We

and almost everyone else who has looked at the treaty think it is swell, a document that so clearly benefits all parties that it may be that which Milton Friedman says there is none of, a free lunch.

Why are the proponents so anxious? What's it all about?

In the most general terms, what the treaty does is protect British investors from the tendency of American tax collectors to become greedy and arbitrary. At the same time it protects American investors from the tendency of British tax collectors to become greedy and arbitrary.

The folks who are trying to dynamite the treaty in the U.S. Senate, not surprisingly, are the state tax collectors, who are running around yelling that the treaty is a violation of "states' rights" and will cause a loss of revenues to state governments.

There is, broadly speaking, no merit to their arguments although they have a measure of our sympathy. They are constantly being whipped by their political bosses to find revenues that do not anger voters. It is thus inevitable that they would be driven to plucking the feathers of foreign investors, which is precisely why it became necessary for the State Department to get into the act and negotiate this treaty.

All it takes in a state revenue office to show a short-run bulge in taxes is to move the puncuation around in the accounting rules that U.S. subsidiaries of foreign companies must follow. Once the company is established, say in California, Sacramento has a tendency to figure it has no choice but to stand still and be plucked. This is the same mental attitude that once gripped the banana republics of Latin America, until they learned that greedy plucking of foreign investors always meant a drying up of foreign investment.

State tax collectors are not expected to understand the global impact of their narrow-minded administrative manipulations. National politicians are expected to, which is why there is such broad support in Washington and New York among Democrats and Republicans and newspapers that are usually on opposite sides of issues. In California, Gov. Jerry Brown initially sided with his tax collector. Then he took a trip to Japan and realized that potential

Japanese investors in the California economy were staying home. Now he supports the treaty.

All the treaty does is systematize procedures in a way that will prevent states from abusing their tax-collecting powers in a way that ultimately hurts everyone, including their own citizens. The worst abuse tax that will be halted is the state taxing of profits earned outside a state, even profits earned in the United Kingdom. For their part, our British partners will stop double-taxing U.S. dividend income and rebate a barrel of money already grabbed in this fashion. If this isn't a free lunch, it's at least the next best thing.

[From the New York Times, May 9, 1978]

THE NATIONAL STAKE IN A TAX TREATY

For a generation, except in the recession year of 1977, the exports of the industrial countries have been climbing annually about twice as fast as production, spurring growth rates, income and prosperity. That growth has depended on the reduction of barriers to international trade and investment, but many impediments remain. One of them is the discriminatory taxation of American investments abroad, and it can be significantly reduced if the Senate this week approves a new tax treaty with Britain. It would also reduce discriminatory taxation of British companies in the United States: unfortunately, it is opposed by several state governments that fear the loss of revenue. The two-thirds vote needed for ratification is in doubt.

The pending pact, arduously negotiated over three years, would replace and modernize a 1945 treaty. The major gain for American investors is a provision that would grant them relief from the double taxation of business income as it appears as corporate earnings and dividends. Britons now get such relief in the form of tax credits; the new treaty would qualify Americans for cash refunds and put them on much the same footing.

Refunds of about $85 million a year are at stake. A retroactive payment of $375 million for the 1973-78 period would also be made — a not-insignificant boost for the dollar, as the Treasury has observed. Moreover, the treaty would set a standard for

similar negotiations with West Germany, France, Canada and other nations. Its approval clearly would serve American interests.

Because the United States continues to tax both corporate earnings and dividend distributions, it had to offer Britain other concessions to gain the treaty. The one that has aroused the greatest opposition would limit a type of taxation by state governments that discriminate against subsidiaries of British companies. Several governors have invoked the cry of "states" rights to challenge the treaty. Tax officials of a dozen states have written to President Carter protesting that such treaties would significantly reduce the revenues of 32 states and also create a chance for tax evasion by American-controlled multinational companies.

The treaty would prohibit states from taxing subsidiaries for any part of the income of a parent company outside the state. However, the Treasury would help the states to apply the complicated "arms length" calculations used by the Federal Government to guard against the understating of a subsidiaries profits. A letter from Treasury Secretary Blumenthal to the 50 governors argues persuasively that this should adequately protect their taxing power. Mr. Blumenthal also argues that the revenue losses are likely to be small and probably be offset by new investments that the present system now discourages. He offers assurances that present taxing methods would continue to apply to American-controlled multinational companies.

California, with the largest stake in the present system, is now supporting ratification. Governor Brown evidently discovered on a trip to Tokyo that prospects for Japanese assembly plants and other investments in California would be improved by such tax changes. The national interest, too, will be served if the Senate rejects the proposed reservations and approve the treaty.

Mr. SPARKMAN. Mr. President, I believe that Senator Church is prepared to make remarks on this treaty and I yield to him.

The PRESIDING OFFICER. The Senator from Idaho is recognized.

UP RESERVATION NO. EX-40

(Subsequently numbered reservation No. Ex.-1.)

MR. CHURCH. Mr. President, I send to the desk a reservation to the pending treaty which relates to article 9(4) and ask that it be stated.

The PRESIDING OFFICER. The clerk will state the reservation.

The legislative clerk read as follows:

The Senator from Idaho (Mr. Church) proposes an unprinted reservation numbered Ex-40:

Before the period at the end of the resolution of ratification insert a comma and the following: "subject to the reservation that the provisions of paragraph (4) of Article 9, as amended by the Notes relating to the Convention which were exchanged on April 13, 1976, shall not apply to any political subdivision or local authority of the United States."

The PRESIDING OFFICER. There are 4 hours on the reservation.

Mr. CHURCH. I yield myself such time as I may require.

Mr. President, before the Memorial Day recess, Members of the Senate received a letter urging them to oppose this reservation of article 9(4) of the proposed United States-United Kingdom Tax Treaty. The letter repeated arguments in support of the treaty which, in my judgment, do not withstand close analysis. I would like at this time to respond to those arguments.

There are two important principles at stake in this treaty. The first concerns the role of tax treaties in our constitutional system. Whatever tax treaties are good for, they should not be used to usurp for the executive branch of Government the power to impose major changes in internal tax policy. Yet, the United Kingdom Treaty does precisely this.

For some 10 years, Congress has been rejecting the type of limitation on the power of our State governments to tax which is incorporated in article 9(4) of the pending treaty. Yet, if this article is adopted, it will serve as a precedent for the future.

No one has suggested that this provision would be confined to the bilateral agreement between the United States and the United Kingdom. It is anticipated, should this provision remain in the treaty, that it will be inserted in all future treaties with other foreign governments, and we must consider it in this light.

In due course, the executive branch, through the device of these many new tax treaties, actually will work a change in our internal tax laws, imposing for the first time a limitation upon the right of State governments to choose the method by which they tax foreign-owned corporations doing business within their jurisdictions. And that change of policy will be accomplished without consultation with the States that are affected, without any participation on their part — indeed, without the consent of the Congress of the United States and without action by the appropriate tax committees of the House of Representatives and the Senate.

Many words have been spoken about the need for Congress to reassert its rightful legislative prerogatives. Yet, the United States-United Kingdom Treaty now before us represents legislative policymaking by the executive through the device of a tax treaty.

The second important principle concerns [p. 18417] the proper way for resolving disputes within our federal system. As I mentioned a moment ago, the States were never consulted before their tax powers were bargained away for the benefits of the multinational corporations. They were informed afterward, and then only through happenstance, when they suddenly discovered this provision, article 9(4), in the treaty now before us.

Mr. President, Congress is the forum in which disputes within the federal system meant to be resolved. In Congress, both sides can make their case, and reasonable compromises are possible. Ironically, the letter from supporters of article 9(4) suggests that the principle of resolving Federal disputes within Congress rather

than through the treaty process "is an attack on the exercise by the Senate of its power to give advice and consent on tax treaties."

Mr. President, that assertion lacks both logic and historical truth. The original purpose for the Senate's role in the treaty process was to protect the interests of the several States in treaty matters. The framers feared that to give the executive branch of the Federal Government free rein in the treaty process would enable the President to ride roughshod over the States. We may have waited a while to see that fear confirmed, but that is exactly what article 9(4) of this treaty does. It demonstrates that the fears of the framers of our Constitution were well founded.

Mr. President, multinational corporations have a long list of disputes with the States, not only in the tax area but in other areas as well — natural gas development, offshore drilling, land use, environmental standards, corporate and foreign ownership of farmland, among others.

If we consent to this precedent-setting article 9(4) of the United Kingdom Treaty, we invite the use of the treaty process in the future, without participation of the States, to settle these many other points of controversy.

Those of us in the Senate who oppose article 9(4) are not alone in our concern for these principles. The same provision is strongly opposed by the California Comptroller and the Franchise Tax Board; by the Governors of Alaska and Oregon and 16 other States, including my own - by some 26 State tax commissioners; by the AFL-CIO; by the Consumer Federation of America; by the American Federation of State, County, and Municipal Employees; by the National Association of Machinists and Aerospace Workers; by the Oil, Chemical, and Atomic Workers International Union; by the National Farmers Union, and by the National Democratic Committee's Farm Caucus.

This provision in the treaty is supposed to be justified by the alleged abuses said to have occurred in the State of California in its application of the unitary method for taxing the multinational corporations doing business in that State.

Mr. President, if we were to set aside the question of whether or not these allegations are well founded and were to assume, for the purpose of argument, that abuses may have occurred in California, the fact remains that similar charges have not been made against any other State that has adopted the unitary method. In our hearings, there were no such charges alleged against the other 42 States and the District of Columbia which are presently using all, part, or a variation of the unitary method in determining the tax to be assessed against a multinational corporation.

So all we have to justify this article is the charge that in certain instances the determinations made by the State of California were abusive and worked to the disadvantage of the large companies there.

I think that is a very thin basis upon which to justify the inclusion in this treaty of an article of this kind, for the treaty is not confined to the State of California. It limits the power of every State government to determine the method to be used in taxing foreign-owned corporations doing business within the State.

Furthermore, Mr. President, if any given State applies the unitary method in a way that business finds to be onerous there are remedies that are available. Until now we had always thought those remedies sufficient. In the first place, the business concern can effect its own remedy by simply withdrawing from the State and taking its business elsewhere. Or the State legislature, faced with complaints of this kind, can readily refashion its law so as not to cause an exodus of capital.

For 200 years now we had thought that this self-correcting process was sufficient. We had thought that it was unnecessary for the Federal Government to intervene via a treaty with a foreign government to prohibit all the States from adopting the unitary method to tax these great global corporations.

I think we will regret the precedent established by this treaty if the Senate chooses not to strike article 9(4) from the treaty by way of the reservation I propose.

Finally, Mr. President, there is the question of the revenue impact of the United Kingdom Treaty on the United States. The Treasury Department states:

The overall impact on Federal tax revenues of the changes from the present U.K. Treaty is expected to be no more than a few million dollars.

Mr. President. I cannot find any basis for such a statement. The Congessional Budget Office judges that the 5-year cost of the United Kingdom Treaty in millions of dollars to be as follows: The revenue loss for 1978 to the Federal Treasury will be \$100 million; in 1979, \$28 million; in 1980, \$31 million; in 1981, \$35 million; in 1982, \$40 million; and in 1983, \$45 million.

The Budget Office made no estimate of the potential revenue loss to the United States from making creditable dollar for dollar against U.S. taxes, Britain's advance corporation tax, known as the ACT or its petroleum revenue tax, known as the PRT.

The revenue effect section of the Foreign Relations Committee report on the United Kingdom Treaty indicates that by making those taxes creditable, the potential loss of the ACT is somewhere between \$50 million and \$100 million for the 1975-78 period, and \$15 million to \$25 million a year thereafter. The potential revenue loss from the PRT ranges from between \$300 million and \$600 million a year by 1983.

These are very sizable losses. Further, these figures are confined only to the impact of this treaty between the United States and the United Kingdom.

But what will be the real loss to the U.S. Treasury? When the principles incorporated in this treaty are extended to all new tax treaties between the United States and all other foreign governments, the global tax loss to the U.S. Treasury will be staggering.

In summary, Mr. President, it is clear that the executive branch is attempting to induce the Senate to approve an undesirable treaty that will have high costs to the U.S. Government, and to use the treaty process both for the initiation of new tax policy within the United States and for the resolution of disagreements within the Federal system.

We have lived to regret past concessions of our legislative roll and we will live to regret again any decision that retains article 9(4) in the pending treaty.

Mr. President, one of the States that has adopted the unitary method of taxing foreign-owned corporations is the State of Alaska. My attention has been called to a very interesting advertisement of the Exxon Co., which was published in Alaska in which the following two questions and answers appear:

Question. How does the State determine how much of a multistate company's income is taxable in Alaska?

ANSWER. Under current law a multistate or multinational corporation's total world-wide income is apportioned to Alaska by an equally weighted three-factor formula based on the percentage of the company's total property, payroll, and sales in the State. For instance, if the company has 25 percent of its total property, payroll and sales in Alaska, the company pays Alaska corporate income taxes on 25 percent of its total Federal taxable income — at the corporate tax rate of 9.4 percent. Variations of this same formula are used in 42 other States and the District of Columbia in calculating income to attribute to multistate companies.

Question. Would Alaska change the formula under the legislation now proposed?

ANSWER. Yes. One bill would delete the sales factor and substitute an extraction factor. Supporters of the measure ignore the fact that production activity (extraction) is measured by the property and payroll factors and that Alaska also already levies a high tax on production through the severance tax. Another proposal is a separate accounting bill. We believe Alaska's present income tax law as it applied to the oil and gas industry in Alaska is equitable and provides uniformity with other industries and most of the other States that levy income taxes. A departure from this uniformity could result in overlapping taxation by the States.

Mr. President, it is unusual for a large multinational corporation like Exxon to speak with favor about any tax. Yet clearly Exxon endorses the unitary tax in Alaska.

No case has been made to justify the Federal Government's intervening by way of article 9(4) of the U.K. Treaty [p. 18418] to prohibit Alaska, Oregon, and California from using a unitary tax method. No case has been made to prohibit its use by the 42 other States and the District of Columbia that have adopted variations of this formula.

Why should the States be forced by the Federal Government to adopt an arm's-length method of assessing the proper allocation of costs and determination of profits between subsidiaries and parent corporations that operate on a global scale?

In the course of the investigations that I conducted of multinational corporations we heard much testimony about the unsatisfactory character of that method, about the inability of the Federal Government to accurately allocate costs or determine where profits lay within such enormous corporations. If the Federal Government cannot do it with all of the expert advice available to the Internal Revenue Service, with all of the accountants at the disposal of our national Government, then how can we expect State governments, limited in their resources, limited in their accounting and bookkeeping capacity, to successfully invoke an arm's-length method to determine what part of the profit of a great corporation can be attributed to that State?

What business is it of the Federal Government to intervene through an agreement that has been negotiated with the United Kingdom and say to the 50 States:

You cannot adopt a unitary method because Washington and London have agreed that British-owned corporations may not be taxed by the States in this fashion?

It has never been done before.

This is a mischievous extension of the treaty power to fashion internal tax policy. Again and again Congress has been asked to establish a national policy limiting State governments in their method of taxing multinational corporations. Again and again Congress has refused. Yet it was Congress that was supposed to decide such matters.

Now we propose to override a refusal by Congress to restrict State governments by imposing that restriction in the form of article 9, section 4 of the pending treaty with the United Kingdom.

We will regret doing it as time passes and we find that the treaty power is again and again invoked to circumvent both the Congress and the States.

For these reasons, Mr. President, I hope very much that the Senate will see fit to strike article 9, section 4 from the treaty by way of my reservation to the resolution of ratification. That vote, I understand, will come tomorrow, and I would hope that if Members of the Senate carefully study the issues at stake here the proposed reservation will be adopted.

Mr. President, I reserve the remainder of my time.

The PRESIDING OFFICER. The Senator from New York.

Mr. JAVITS. Mr. President, I yield myself 15 minutes.

The description of what is taking place here is very analogous to the blind man and the elephant. The particular provision to which my colleague refers is but a part of a larger whole which is of great interest and of great importance to the United States in terms of Federal income tax revenue, and to the business community of the United States.

It has been pointed out, I think quite properly, that the concern about article 9(4) emanates from three States, the largest being California. If I can read the official position of the State of California to the Senate we would put in sharp focus what I meant when I said we have here a presentation of the blind man and the elephant, the blind man who could touch but one infinitesimal part of the elephant and not understand its whole.

We have a declaration, in telegram form, from the Governor of California and one of its Senators, which is found at page 399 of the record of the Foreign Relations Committee hearings on the treaty, and which reads as follows:

Hon. John J. Sparkman
U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR SPARKMAN: Since our separate letters to you on July 21, 1976, and April 1, 1977, regarding the United States-United Kingdom Tax Treaty, we have been informed that the revenue loss to California will be far less than $100 million to $125 million originally indicated. The direct loss of tax revenue to California resulting from the exclusion of the foreign operations of foreign parent corporations from the unitary method of taxation may be 15 or 20 million dollars.

Furthermore, it is the judgment of California's Business and Transportation Secretary, Richard Silberman, and the State Director of Finance, Roy Bell, that ratification of the treaty will have a positive net economic impact on California.

Secretary of the Treasury Blumenthal has specifically requested our support for ratification of the treaty and has emphasized that the Carter Administration believes it to be in the international interest.

In light of the above, it is our judgment that it is in the best interest of California as well as the nation that the United States-United Kingdom Tax Treaty be ratified.

Sincerely,

EDMUND G. BROWN, JR.,
Governor.

ALAN CRANSTON,
U.S. Senate.

I understand, that, Senator HAYAKAWA will speak tomorrow, to the same effect, having already manifested in his testimony before the committee his support for the committee's position.

Now, Mr. President, I opened with Governor Brown's letter for this reason: I yield to no one in my respect and regard for my friend from Idaho, who has proposed this particular reservation, but I urge the Senate to look at the whole treaty, before we get diverted on to this particular proposition, which will have, in my judgment — and, incidentally, this is Secretary Blumenthal's judgment as well, not just mine — the effect of killing off this treaty.

The fact is, Mr. President, that this particular treaty was negotiated with the British at a time which was extremely favorable to us, a time when Britain was in considerable economic difficulty and was reaching out for ways in which she could improve her situation.

This treaty was attractive to England because she was smarting under serious economic difficulties, but we were smarting very much more. Mr. President, because there were hundreds of millions of dollars in taxable U.S. income which were tied up in British, and which could not be paid to American investors, both portfolio and capital investors, because of British law, which discriminated against American investors by not providing them with refunds of the Advance Corporation Tax, which British investors were getting.

These dividends, if you were a United Kingdom citizen, were rebatable under their unitary apportionment tax system, but they were not rebatable to U.S. citizens, and so American investors were completely hung up beginning in 1973, when that law passed, to the tune of hundreds of millions of dollars.

The purpose of this treaty was to loosen up that money, and the treaty will result, if ratified this year, in cumulative refunds of approximately $375 million, to be repatriated to the United States, with subsequent annual refunds totaling $85 million — an annual tax benefit to the U.S. Treasury.

Also, Mr. President, and I now cite Secretary Blumenthal:

The proposed treaty is also very significant from the standpoint of international tax relations. It is the first treaty ever to reconcile successfully a classical system of corporate taxation such as that of the United States with the type of integrated system currently in place in many developed countries. Without such a reconciliation, United States investors encounter discriminatory taxation in countries having such integrated tax systems. We are hopeful that the provisions in the proposed treaty dealing with this discrimination will serve as a model in our current treaty negotiations with France, Germany, Canada, and other countries that have integrated systems similar to that of the United Kingdom.

Coming now to the particular matter about which Senator CHURCH has been debating today: this article represents a concession which we have made to the United Kingdom. It is one of the very few concessions made in this treaty; and the whole cost of the concession, in terms of State revenue, Mr. President, is estimated at $25 million for the three States which are referred to — and, by the way, Idaho has not even installed this system; it may wish to, but it has not done so. Of the three States we referred to, the potential taxation for California itself amounts to only $15 million or $20 million. Yet we are asked to kill off the whole treaty for that reason.

Let me tell the Senate why I say we are asked to kill off the whole treaty for that reason. Here is what Secretary Blumenthal said in his letter of May 2, 1978. I ask unanimous consent that the entire letter be printed in the RECORD at this point.

There being no objection, the letter was ordered to be printed in the RECORD, as follows:

[p. 18419] THE SECRETARY OF THE TREASURY,
Washington, May 2, 1978.

HON. JACOB JAVITS,
U.S. Senate, Washington, D.C.

Dear Jack: A proposed new income tax treaty between the United States and the United Kingdom will soon be before the Senate. The Treasury supports this treaty, and I am writing to urge that you vote for its ratification.

The proposed treaty is extremely advantageous to the United States. One of its most important provisions obligates the United Kingdom to make substantial refunds of taxes (estimated to

amount to some $375,000,000 for the retroactive period from 1973 to 1978, and about $85,000,000 each year thereafter) to American investors in United Kingdom corporations. A transfer of funds of this magnitude from a foreign Treasury to United States investors should help both our balance of payments and the value of the dollar in foreign currency markets.

The proposed treaty is also very signifcant from the standpoint of international tax relations. It is the first treaty ever to reconcile successfully a classical system of corporate taxation such as that of the United States with the type of integrated system currently in place in many developed countries. Without such a reconciliation, United States investors encounter discriminatory taxation in countries having such integrated tax systems. We are hopeful that the provisions in the proposed treaty dealing with the discrimination will serve as a model in our current treaty negotiations with France, Germany, Canada, and other countries that have integrated systems similar to that of the United Kingdom.

Some persons have objected to Article 9(4) of the proposed treaty, which limits the application of the so-called unitary method of taxation. The unitary method is a means of allocating the income of a multi-jurisdictional business among the relevant taxing jurisdictions, through the use of a formula. The method is not employed by the federal government but is employed in various forms by certain states. I believe that Article 9(4) has been the subject of considerable misunderstanding.

The Article prevents the application of the unitary method with respect to the income of foreign corporations controlled by United Kingdom interests. We understand that only three states — California, Alaska and Oregon — extend the unitary concept to such income, that is, income of foreign corporations controlled by foreigners. The inclusion of Article 9(4) in the treaty was strongly urged by the British on the ground that the unitary method as applied to United Kingdom corporate groups imposes excessive recordkeeping and reporting burdens and often results in state taxation of income having no connection with the taxing state, thus violating a basic international tax principle. The article will have the salutary effect of limiting a system of taxation which

foreign investors often find burdensome, unfair, and a disincentive to investment in this country.

From the standpoint of the United States, Article 9(4) represents a narrowly drawn and relatively minor concession, by any measure, in relation to the overall balance of benefits in the treaty. The treaty makes clear that states are not in any way precluded from using the arm's length method of controlling prices in transactions between related parties to ensure that a multijurisdiction business does not arbitrarily shift income from one tax jurisdiction to another. The arm's length method is employed by the taxing government, and the transfer price information developed in federal audits can be made available to state tax authorities. Thus, the treaty restriction on unitary taxation should not have a serious impact on tax revenues, if indeed it has any adverse impact at all. Moreover, it is reasonable to conclude that other aspects of the treaty, especially the provisions requiring refunds of United Kingdom taxes, will tend to increase state revenues.

It would be extremely unfortunate, in my view, if the Senate were to enter a reservation on Article 9(4) or otherwise fail to ratify the proposed United Kingdom treaty as it stands. A reservation would require that the treaty be sent back to Parliament for reconsideration. After a review of the new balance of concessions in the revised treaty, Parliament might enter reservations of its own, which would be costly to U.S. investors, the Treasury, and the states. Moreover, further delay in achieving ratification could do considerable damage to our efforts to reach satisfactory international tax agreements with other countries.

For these reasons I respectfully urge that you vote for Senate ratification of the proposed treaty.

Sincerely,

W. MICHAEL BLUMENTHAL

Mr. JAVITS. I would like to repeat particularly these closing sentences:

It would be extremely unfortunate, in my view, if the Senate were to enter a reservation on Article 9(4) or otherwise fail to ratify the proposed United Kingdom treaty as it stands. A reservation would require that the treaty be sent back to Parliament for

reconsideration. After a review of the new balance of concessions in the revised treaty, Parliament might enter reservations of its own, which would be costly to U.S. investors, the Treasury, and the states. Moreover, further delay in achieving ratification could do considerable damage to our efforts to reach satisfactory international tax agreements with other countries.

For these reasons I respectfully urge that you vote for Senate ratification of the proposed treaty.

Now, Mr. President, to go on: It has also been said in the arguments that this is an unprecedented restriction upon State authority. But, Mr. President, this is not breaking new ground at all. There are many tax treaties to which the United States is a party, in which the States are prohibited from imposing discriminatory taxation on foreign residents and foreign companies. That is almost universal in tax treaties, and that is a very important restriction on States.

Also, Mr. President, there are treaties like the Vienna Convention which limit the application of State and local taxes respecting foreign diplomatic personnel. Again, to a place like New York, that is a tremendous restriction. We have them all. But nonetheless, Mr. President, we have to yield to the national will.

In addition, Mr. President, there is an alternative to this unitary method of taxation as far as the States are concerned. Most of the States have what is called the arm's-length system, which is considered to be, by our own Treasury and by all of these States, a very much fairer way of assessing taxation.

Indeed, the reason that the United Kingdom insisted on the exclusion of this unitary tax method is because it is basically unfair. It has no relation whatever to property owned or business done. It simply represents an attempt to apportion tax on the global operations of a particular foreign enterprise which happens in the case of this treaty to be a United Kingdom enterprise. Hence they rebelled against it. The arm's-length system on the other hand is based upon business done and property owned in the United States.

Now, the unitary tax system in some form may be applied in many States, but these States limit the application to the domestic operations of foreign corporations. If a foreign corporation does business in 40-odd States of the United States, certainly in that case you can make an apportionment based on the unitary approach for the operation of the corporation in the States; there is nothing unfair about that. But in worldwide operations with no relation to U.S. business, I think the United Kingdom is absolutely right; this should be prevented. And, as I say, the application of the unitary system in the global operations of non-U.S. corporations has been done only by very few States, and involves very modest amounts of money.

The critical question is therefore the following: After all this time and with all of the benefits accruing from this treaty in terms of the business operations of the United States, the increased revenues to the U.S. Treasury and in terms of increased American investment in other developed countries with comparable tax systems to that of the United Kingdom, shall we, in effect dump this treaty for this particular article, considering the relationship which it represents to the total proposition?

The Foreign Relations Committee voted 10 to 5 against recommending a reservation based upon exactly these arguments which were made by Senator CHURCH and myself; and I respectfully submit that this was the right decision.

Just to finish, and then I will yield to the majority leader. I would like to explain the reason for my active participation in this procedure. Why am I involved? Why have I suddenly taken up this matter and become a manager of a treaty?

The reason is, Mr. President, that I believe that the future of this world is in the fair opportunity available to Americans to invest everywhere and to foreigners to invest here. The development and aggrandizement of that opportunity represents the capacity of the capitalist system to triumph over the Communist system which is so material to the facilitation of world trade, so that we do not have the parochialism destroying the free world today.

So my interest is in the precedent, and the results that will automatically accrue.

Mr. President, I yield to the majority leader.

Mr. ROBERT C. BYRD. I yield to the Senator from Louisiana.

* * *

[p. 18421] Mr. CHURCH. Mr. President, let there be no misunderstanding about the fact that the particular Article 9(4) in the pending treaty is unprecedented. The Senator from New York says we already have tax treaties which provide that foreign diplomats in New York City will not be subject to State or local taxes. Therefore, article 9(4) is not unprecedented.

Well, that is true, Mr. President. We also have provisions in tax treaties which provide that State governments may not discriminate. That is to say, they may not tax a foreign-owned corporation doing business within that State at a higher rate than they would tax a home-owned corporation.

These nondiscriminatory provisions or these provisions that relate to the traditional immunity that is granted to foreign diplomats in this country are of an entirely different character, dimension, and scale from what will be wrought by the inclusion of article 9, section 4, in the pending treaty, because never before have we gone beyond these nondiscriminatory provisions in tax treaties to say to State legislatures that they may not choose a given method for imposing taxes on multinational corporations doing business within their boundaries. Never before have we undertaken to interfere with what has been the right of the States to determine tax policy within those States.

I do not ask Members of the Senate to take my word for it.

When the State Department sent this treaty to the President, the letter of submittal, included in executive K as part of the basic treaty documents and forwarded by the President to the Foreign

Relations Committee, acknowledges that article 9(4) is unprecedented with these words:

This provision represents the first attempt to bind State and local taxing authorities by a substantive provision of the treaty.

Furthermore, we have the statement of the staff of Joint Tax Committee prepared for the use of the Committee on Foreign Relations on this same question. This is what they have to say about the provision:

The proposed treaty contains a new provision, Article 9(4), not found in other United States tax treaties or in the OECD Model Tax Treaty, which places limitations on the combined reporting method used by several States of the United States to determine the taxable income which corporations derive from sources within the State.

So that should settle the argument as to whether or not this article is unprecedented. Clearly, it is.

In his argument, the distinguished senior Senator from New York said that the revenue losses to the State of California would not be very large if we were to ratify this provision and include it in the treaty. He said, as I recall, that the losses might be as little as $20 million or $25 million.

Well, Mr. President, that is subject to considerable dispute in California. The Governor is engaged in lively argument with both the State Comptroller and the Franchise Tax Board in California, and they take a vey different view from that currently expressed by the Governor, who, incidentally, a few months ago opposed this article and then reserved his ground. But neither the California Comptroller nor the California Franchise Tax Board reversed their ground. They have testified strongly before the Senate Foreign Relations Committee against retention of this provision in the treaty, on the ground, among other reasons, that it would occasion a very serious revenue loss to the State of California. The Tax Commission places their estimate of the loss at $125 million.

What about Alaska, Mr. President? I know that the distinguished Senator from Alaska, who will speak here soon, will cover this subject fully. But I do not think it inappropriate to include at

this point in my argument the estimate of Sterling Gallagher, commissioner, Department of Revenue of the State of Alaska, who appeared as a witness at the time of the hearings. Senators will find on page 146 of the hearings his statement to the effect that this treaty will cost the State of Alaska in 1980 around $50 million.

For a State the size of Alaska, that is a great deal of revenue, indeed.

So I reject the contention of the Senator from New York that this will have minimal impact upon the States. It is not borne out by the weight of the testimony before the committee.

My good friend, the able Senator from New York, who is very knowledgeable in tax and financial matters, has suggested to us that we ought not look at article 9, section 4 alone, that this, after all, is but one piece in a great mosaic, which is the treaty taken as a whole.

He makes the case for the treaty taken as a whole, suggesting that somehow if we were to reserve our consent on article 9, section 4, the whole treaty would collapse.

Mr. President, I cannot accept that argument. I do not think that there is a basis for it in the RECORD. Rather, from what I know of the negotiations, I believe that had we not offered article 9(4) as a concession, we still could have secured the British tax reductions for the American corporations as contained in the treaty.

One need only peruse the treaty to realize the magnitude of our other concessions, which should have obviated the need to concede article 9(4).

For example, we have agreed to exempt all British insurance companies from paying the customary insurance excise tax. Because 50 percent of foreign insurance that insures U.S. risks is owned by British investors, this tax exemption will result in major revenue losses to the U.S. Treasury.

We have also agreed to offer foreign income tax credits to the oil companies for the special taxes that they pay to Britain on North Sea oil activities — contrary to a ruling by the Internal Revenue Service in 1975 — with a potential cost to the U.S.

Government of some $300 milion to $600 million annually by 1983.

We also create by this treaty a shipping haven in the United Kingdom, and we make Britain's advance corporation tax creditable, dollar for dollar, against the U.S. tax, again at an enormous potential cost to our Treasury.

Finally, I would like to point out that the Dutch have recently negotiated a tax treaty with Britain that provides for a tax break to Dutch corporations in Britain, but does not require any change in the Dutch taxation of British corporations similar to article 9(4).

In sum, it appears that the American concession was unnecessary and, in fact, should not have been offered in the first place.

So I do not think we can take it as an article of faith that if we strike this particular provision from the treaty all the work entailed in this negotiation will collapse and the treaty itself will fall.

[p. 18422] Finally, Mr. President, let me emphasize that the benefits in this treaty do not abound to the Government of the United States, nor to the American people as a whole. The benefits we derive from this treaty are directed toward the stockholders of American-owned companies doing business in Great Britain — a very narrow group of well-to-do people. They are the ones for whom the treaty has been crafted. They are the ones who will benefit from its provisions.

I know that multinational corporations want this treaty. I know the difficulty of surmounting their combined influence. It rarely happens. Whether or not the Senate chooses to adopt this reservation, I suggest that it is in the interests of the ordinary people of this country and it is in the interests of the Treasury of the United Staes.

Furthermore, the adoption of this reservation would send a clear signal to the Treasury Department and to the State Department that it is the Congress of the United States that should determine tax policy for this country and that it is regarded as an improper use of the treaty power to attempt to force upon this

country a change in tax policy that Congress, itself, consistently has refused to accept.

Once we begin to use tax treaties for the purpose of legislating internal tax law, once we begin to use agreements with foreign governments as a device for limiting the power of our own State legislatures to adopt tax formulas that are applicable to businesses in their own jurisdictions, we have set ourselves upon a course that we will live to regret.

I can fully understand why so many State governments are calling upon us to reject this provision of the pending treaty, for they know how much is at stake for them if we fail to do so.

For these reasons, Mr. President, I hope that the Senate will see fit to reserve article 9(4) from the consent otherwise given by the resolution of ratification.

Mr. President, I reserve the remainder of my time, and I yield to the Senator from Massachusetts such time as he may require.

Mr. KENNEDY, Mr. President, I give my strong support to the proposed reservation to article 9(4) of the pending tax treaty with the United Kingdom.

The provisions of article 9(4) would prohibit the States of the United States from applying the so-called unitary method of accounting in taxing the income of multinational corporations based in the United Kingdom.

One of the most difficult areas of tax policy is the proper method for allocating the taxable income of multistate and multinational businesses among the various jurisdictions with which the businesses have contacts. In recent years, a number of States have recognized the simplicity and workability of the unitary accounting method, and have adopted it for allocating the worldwide income of multinational corporations to their jurisdictions for the purposes of applying State tax laws.

Under a common version of the unitary accounting method, a proportion of a firm's worldwide income is allocated to a State according to a three-factor formula based on the firm's property, payroll and sales within the State. In part, this procedure has been

adopted by the States in response to devious efforts by multinational corporations to manipulate the income and transactions of their U.S. subsidiaries, in order to remove as much of that income as possible from the reach of State tax laws.

Some claim that it is possible to pierce these corporate shells, to analyze the complex "transfer pricing" and other subtle arrangements by which foreign corporations try to slip beyond State tax commissioners, and to arrive at a realistic definition of multinational profits that can legitimately be taxed by the States.

But few, if any, State tax officials believe that this alternative can work in practice. They have neither the resources nor the time to go through the myriad transactions and structures of the multinational pyramid. It stretches the imagination beyond the breaking point to suggest that the U.S. Treasury Department can fill the gap, by providing the "technical assistance" that State tax offices need to perform this difficult accounting surgery.

Yet article 9(4) of the pending treaty, by outlawing the unitary method of accounting, would relegate the States to precisely this burdensome effort to determine the amounts of income derived by multinational corporations from activities in their States.

In effect, the treaty would nullify, for all practical purposes, the reasonable efforts of States to apply their tax laws legitimately to the income of multinational corporations operating within their borders.

At this time of growing national concern over rising taxes, and widespread efforts in many States, fueled by Proposition 13 in California, to relieve the burden of property taxes on local citizens, it is unfair for the Federal Government to cripple the States in their effort to find reasonable alternative sources of income.

Article 9(4) would have the entirely undesirable practical consequence of allowing multinational corporations to lurk in foreign tax havens, hiding behind foreign subsidiaries and corporate shells, sucking income and profits out of the United States, and then thumbing their noses at State tax commissioners in every State. In effect, the treaty provision would create modern

counterparts of the old foreign gambling ships, plying their trade outside the 3-mile limit, thwarting all the law enforcement efforts of local sheriffs.

The unitary method of accounting has widespread support among tax experts as a simple, efficient, and equitable method of allocating multijurisdiction income for the purposes of State and local taxation. It is a method that is also widely used within the United States for apportioning the income of U.S. firms engaged in business activities in more than one State.

As recently as a week ago today, the Supreme Court of the United States upheld an Iowa statute prescribing — not the preferred three-factor formula — but a more limited, single-factor formula based only on sales within the State. It was argued by corporations subject to the tax that Iowa was using a discriminatory formula that concentrated too much out-of-State corporate income in Iowa, and subjected such corporations to double taxation. But the Supreme Court rejected the claim in Moorman Mfg. Co. against Blair, decided on June 15 by a 6 to 3 majority. According to the Court, the single-factor formula based on sales was not so arbitrary as to be unconstitutional. The out-of-State corporation had failed to prove that the income attributed to Iowa for purposes of Iowa taxation under the formula was "out of all reasonable proportion of the business transacted" in Iowa.

The same principle applies to the pending treaty. Use of the much fairer three-factor formula primarily at issue here should not arbitrarily be denied to the States in their efforts to reach a reasonable allocation of multinational corporate income to activities within their borders.

If the unitary method of accounting produces arbitrary results in some cases, the answer is to change the formula, not to throw out the baby with the bathwater by barring all unitary formulas. Yet this is the approach the Treasury negotiators have taken in bringing article 9(4) to the Senate for ratification.

Mr. President, I would like to mention here a little bit about what we have found in the Senate Antitrust Subcommittee about the accounting procedures by at least one major oil company, the Exxon Co.

It should come as no surprise that the major international oil companies are strong supporters of the proposed tax treaty with the United Kingdom. They obviously stand to benefit from a number of the provisions. But what is remarkable is the enthusiasm with which they have embraced the provisions prohibiting the use of the unitary method of taxing multinational corporations. This position is so obviously inconsistent with what we have heard from the industry in other contexts that it deserves careful examination.

The issue arises because a multinational corporation can artificially reduce its tax burden in a particular State by simply selling its products to a subsidiary in that State at inflated prices. As a result the subsidiary will appear to earn little or no profit in the State, thereby reducing its State tax burden.

This transaction, of course, does not in any way affect the corporation's real profits, since the sale to the State subsidiary was only an intra-corporate transfer, not a real sale.

In an effort to deal with this problem, a number of States have decided that where a corporation functions as a unit, each subsidiary being dependent upon the others, the State should ignore transfer payments and compute its taxes based upon its fair share of the overall corporate revenue. This approach obviously depends upon the unitary nature of the corporation involved. A [p. 18423] corporation that has hamburger stands in State A and a car rental operation in State B is clearly not unitary. It would be unfair to allow State A to use its hamburger connection to tax the car rental profits earned in State B.

What is remarkable about the present situation is that the oil industry, both in State tax proceedings and with respect to this treaty, rejects the unitary concept and strongly endorses the use of transfer payments for computing tax liability. But the crocodile tears now being shed by the industry are clearly at variance with other statements by the industry in other circumstances approving the unitary method.

In 1976, Senator Philip A. Hart, chairman of the Senate Antitrust Subcommittee, called to the Senate's attention certain State Tax Commission litigation involving Exxon. At that time,

vertical divestiture was the issue. Texaco was running television commercials showing how the parts of an integrated oil company fit together like pieces of a puzzle. Mobil ran cartoons of a man hacking up a garden hose to demonstrate divestiture. Congress was deluged with material extolling the benefits of vertical integration and warning of the dire consequences that would come if the intricate system of integration were taken apart. The industry referred to divestiture as dismenberment, conjuring up an image of hacked-off limbs gushing oil, if not blood.

In the midst of this furor, Senator Hart uncovered the fact that Exxon was singing a different tune in Wisconsin at the time Exxon was opposing the State of Wisconsin's effort to use the unitary tax method, on the ground that Exxon was not — I repeat not — a unitary corporation.

Exxon's position was no mere technical tax argument. Completely inconsistent with their divestiture argument, they set out in Wisconsin to demonstrate that, in fact, their corporation was not at all the highly integrated and interdependent organization we had been hearing so much about in Washington. Rather, they had become a group of loosely affiliated organizations that could quite easily be separated with no serious economic consequences.

What is particularly relevant to the present treaty is the fact that, when divestiture was the issue, Exxon actually asserted to the Antitrust Subcommittee that there was no way that the "arm's-length transaction" standard could be used to separate profit and loss figures for its divisions and subsidiaries. Logically, of course, it should be impossible to compute State taxes for each division. The only possible way to compute such taxes should be on a unitary basis.

In December 1975, Senator Hart wrote to a number of major oil companies, incluing Exxon, and requested certain financial data. The letter contained an "Item 5" which asked for "profit and loss" statements and balance sheets, audited or unaudited, separately covering production, transportation, refinances and marketing."

Mr. A. L. Monroe, Exxon's comptroller, replied to Senator Hart's letter, saying:

> . . . Exxon Corporation's financial records are not maintained on a functional or segment basis similar to those categories set forth in your Item 5.

Mr. Monroe elaborated:

> As for further statements of revenue and expenditure data directly attributable to each of the above-mentioned groupings (crude production, refining, marketing and transportation), our corporate records are not maintained in that manner, nor do our independent public accounts prepare such allocations.
>
> The petroleum business is unitary in nature. The most meaningful segmentation of our operations is the "upstream", "downstream" segmentation. Further breakdowns require many allocations and assumptions, which could lead to erroneous comparisons of data between various companies and hence erroneous conclusions.

As Senator Hart pointed out, Exxon's position at that time was inconsistent on two important points with the corporation's position before the State tax authorities.

First, Exxon unequivocally told the Senate that "the petroleum business is unitary in nature." Yet, in the Wisconsin tax proceeding, Exxon's counsel stated:

> Our evidence will show that none of [Exxon's] functional departments, are integral parts of a unitary business; rather each function is independent and not unitary to, or an integral part of, any other function.

Second, Exxon's letter denied the existence of profit and loss statements for separate functions. But in tax litigation in South Carolina, Exxon had filed a complaint which said:

> Each of these functions is managed and accounted for on a functional operating basis. Each is a segment of [Exxon's] total corporate enterprise, but each has its own accounting, budgeting and forecasting, its own management and staff, its own profit center, its own investment center, its own physical facilities, etc.

The profit or loss of each function is separately and accurately computed.

These are not statements taken out of context. They were central to Exxon's case in each proceeding. The statements of Exxon's counsel elaborated on these arguments at great length.

Mr. President, the multinational corporations can not have it both ways. The Senate is entitled to take their opportunistic arguments against this reservation to the tax treaty with a very large grain of salt. Depending on this issue, they whisper an argument into the Senate's divestiture ear and a squarely contradictory argument into the Senate's taxation and treaty ear.

In my view, the Exxon materials vividly demonstrate the shallowness and hypocrisy of the arguments made in favor of article 914 of the treaty. The Senate should reject those arguments, and vote in favor of the pending reservation.

Mr. President, even apart from the lack of merits in the substance of section 9(4), the provision is also vulnerable to serious objections because of the procedure by which it was negotiated.

The desirable method of congressional action in this complex area of taxation should be the route of legislation, rather than treaty. Serious considerations of Federal-State relations are involved here — considerations that are easily slighted by the treaty negotiation and ratification procedure. It would be preferable, therefore, to deal with the issue by legislation, so that the tax committees of the House and Senate may also consider the problem and recommend solutions, and so that the States may have the opportunity they deserve within our Federal system to protect their basic rights in this sensitive fiscal area.

A wiser approach would have been for the administration to submit general recommendations for legislation on this subject. These recommendations would be the subject of discussion and debate in the House and Senate and I am confident that Congress would reach a prompt resolution of these questions in a way that both protects the rights of State governments and deals fairly with multinational corporations.

It is hardly a satisfactory approach for the Senate alone to attempt to make a preliminary and unprecedented resolution of this sensitive issue of States' rights in the context of a treaty.

Finally, the administration asks us — whatever our reasons for opposing the substance and procedure with respect to section 9(4) — to swallow our objections, for fear that if a reservation is adopted, the treaty may be rejected by the British Parliament. I welcome the benefits negotiated for the United States, and particularly for American investors, in other articles of the treaty. But I find the administration's desire to promote U.S. investment in Britain curious, to say the least, in light of our widely shared concern over the sluggish levels of investment here at home.

In any event, I seriously doubt that any responsible action we take in adopting a reservation to article 9(4) will jeopardize the treaty as a whole. There are obvious compromises that can be negotiated to avoid any arbitrary application of the unitary method of accounting to British corporations operating in American States, without taking the drastic and unnecessary step of prohibiting the method altogether.

This treaty itself, signed in London in 1975, has already been the subject of amendment by an exchange of notes and two protocols. It strains credulity for the administration to maintain that another protocol could not be easily arranged with Britain to repair the damage that article 9(4) would do to the States and our Federal system, while fully protecting the rights of British multinational corporations to conduct their business in the United States, free from unjust State laws or overly aggressive State tax commissioners.

The reservation that has been proposed to article 9(4) will not jeopardize the treaty, and it deserves to be supported by the Senate.

Mr. President, I reserve the remainder of my time.

Mr. PELL. Mr. President, I yield such time as he desires to the Senator from Iowa.

The PRESIDING OFFICER. The Senator from Iowa.

[p. 18424] Mr. CLARK. I thank the Senator very much.

Mr. President, I agree with the remarks of the Senators from Idaho and Massachusetts.

I, too, am extremely concerned about the propriety of placing such unprecedented limits on taxing, particularly State taxing authority through the vehicles of a tax treaty ratified by only one House of Congress. This constitutes little more than the IRS deciding, by fiat, what method of taxation the States may use. As far as I am concerned, this is a bad way to make tax policy. The issue should be addressed thoroughly by both the House of Representatives and the Senate and by their Ways and Means and Finance Committees, particularly.

Mr. President, I am especially troubled, because of the potential impact such a tax policy could have on farm States. Conservative estimates are that there is nearly $1 billion of foreign investment in U.S. farmland. Speculation is that the actual amount of foreign investment in farm properties is actually much higher than that.

One of the problems, of course, has been that records on foreign ownership of real estate are very sketchy. In fact, the Commerce Department has frankly admitted its inability to get a handle on foreign ownership of farmland.

Mr. President, I would ask unanimous consent to include at this point in my remarks several articles which appeared in Business Week and the Saturday Review which reflect the growing concern about the incidence of foreign ownership of U.S. farmland.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

FOREIGN INVESTORS FLOCK TO U.S. FARMLANDS

Other investment markets have waned, but a cheap dollar, political instability overseas, and a long record of rising prices have made U.S. farmland the single hottest area for foreign investors. Although much of the foreign money is hard to trace, European Investment Research Center, a private consulting firm

based in Brussels, estimates that foreigners invested some $800 million in farmland last year. That would come to a startling 30% of all foreign direct investment in the U.S., according to the Commerce Dept. "What we are witnessing, says Kenneth R. Krause, a senior economist for the Agriculture Dept., "is the biggest, continuing wave of investment in American farmland since the turn of the century."

Nor does it look as if the trend is slowing down. Real estate advisers and brokers report that the buying interest, mostly from Western Europe but also from Latin America and Japan, is on the increase. The Arab oil states have apparently not yet been big investors. And marketing activity aimed at the potential investors is heating up. For example, Amrex Inc., a San Francisco-based real estate firm, is holding a meeting in Zurich next week to introduce buyers to sellers who represent as much as $750 million worth of U.S. farmland. Some observers warn that the industry is attracting its share of hucksterism as well. West German newspapers are being flooded with real estate advertisements, apparently from small U.S. brokers, that often offer only an anonymous post office box number for an address.

Predictably enough, U.S. farmers are irate, and the Agriculture Dept. and, most recently, Congress are growing increasingly concerned as well. Despite some recent softening, farmland prices are dramatically higher than they were a few years ago, and critics blame foreigners for much of the speculation. Also, many foreigners can take special tax breaks at home or through Caribbean subsidiaries that give them a significant advantage over domestic investors. Since last year's $24 billion in agricultural exports represented a major component of U.S. trade, Washington is especialy worried about increasing foreign control of U.S. farmland.

What also concerns the Agriculture Dept., as well as local farmers, is that the identity of the foreign purchasers is seldom known. Brokers and bankers steadfastly refuse to divulge names although they claim that most investors are wealthy individuals rather than corporations or investment groups. "We simply cannot get a handle on farmland," says a Commerce Dept. official,

"since ownership is disguised through the extensive use of trusts, partnerships, and corporations headquartered offshore."

SAFE INVESTMENT

Angry farmers and their allies in state capitals are trying to crack down on foreign investors by seeking registration of ultimate ownership and outright restrictions on foreign purchases. Kansas and Missouri have recently undertaken investigations of foreign investments. And the General Accounting Office is just beginning what will be the most sweeping probe. At the request of the Senate Agriculture Committee, the GAO will try to determine the extent and locations of foreign investment in farmland. "Once we get answers to these questions," says one committee aide, "we will decide what, if anything, we shall do about the trend."

The weakening dollar is only the latest of a number of reasons that foreigners are so attracted to farmland. Political instability in their home countries is pushing foreigners into U.S. investments. With stock and bond prices both down, real estate in general, and farmland in particular, is drawing foreign money. Many Europeans also believe that agricultural land is guaranteed to retain its value because they anticipate worldwide food shortages in the future. "American agriculture is nothing less than the safest investment around," says Ernst-Ludwig von Bulow, who specializes in U.S. real estate for a Hamburg-based investment fund, Lehndorff Vermogensverwaltung.

Present economic trends in U.S. agriculture have further whetted the foreigners' appetites. Land prices in recent months have fallen or softened just about everywhere, including the corn belt, but more noticeably in the Great Plains. As a result, the current annual rate of growth in farmland values has slowed to 5 percent or less from 17 percent a year ago. The slippage is due primarily to the continuing cost-price squeeze on American farmers, which is being worsened by depressed farm prices.

SUNBELT PURCHASES

But if land prices begin soaring again, it still makes sense for the Europeans to buy in, say real estate advisers. Farmland prices in Western Europe are roughly double the price of the same quality land in the U.S. — $3,000 an acre for prime farmland in West Germany and France vs. $1,500 an acre in the U.S. last year, according to Chicago's Northern Trust Co., which manages about 400 farms in 35 states.

While it is difficult to pinpoint where foreigners are buying most heavily, Jules A. Horn, director of the European Investment Research Center, says the so-called Sunbelt, which runs across the bottom third of the U.S., is attracting most of the money. He considers prices ranging between $600 to $1,000 an acre to be particularly attractive to Europeans. Until the present sag in the land price boom, Horn says, Europeans were far more interested in investing in California and the upper Midwest states such as Illinois and Wisconsin.

Hamburg-based Lehndorff has kept its investors out of the nation's richest farmland states, such as Iowa and Indiana, preferring to concentrate investments in Wisconsin, Missouri, and Arkansas. Singled out by von Bulow: farmland near the resort area of Lake Geneva, Wis., 60 miles from Chicago. "Lake Geneva is gradually expanding," he says, "which means that we may eventually be able to sell the land for construction." Jeffery White, head of Iowa Agronomics Inc., a farm management firm, adds that prices for Southern farmland are down drastically this year, and bargain hunters could come up with good buys in such states as Arkansas and Texas.

Meantime, real estate firms report that the growth in foreign business is providing a major fillip to their sales. Oppenheimer Industries Inc., Kansas City (Mo.)-based farm brokerage and management firm that operates a rural land portfolio comprising roughly 1 million acres of farm and ranch land, for example, reports that sales to foreign investors more than doubled in the past few years and now account for one-third of its annual volume. A typical Oppenheimer deal recently involved the purchase of a 1,215-acre soybean and corn farm for nearly

$1 million by a Western European. Two weeks ago, the company helped an Italian investor buy a 315-acre citrus grove for $1.4 million. San Francisco's Amrex says that of the approximately $100 million in agricultural deals that it arranged last year, half were with foreigners.

UNFAIR COMPETITION

What especially worries U.S. officials is the possible widespread use of foreign tax havens by farmland investors. Lionel S. Steinberg, director and former president of the California State Board of Food & Agriculture, finds it "totally objectionable" for foreign investors to buy California land through corporations headquartered in the Dutch Antilles, for example, which require payment of little or no income taxes. "This is unfair competition and a threat to bona fide family farming in the U.S.," says Steinberg, noting that tax-priviliged foreign investments make it difficult for prospective local buyers to compete.

NOTHING SINISTER

Understandably, brokerage firms, banks, and other intermediaries for foreigners are defensive about their activities. "Much of the paranoia concerning absentee ownership is due to poor communications," declares Reed J. Oppenheimer, vice-president for Oppenheimer's international activities. "These people are not the suspicious cloak-and-dagger people they are made out to be," he says.

Nevertheless, Oppenheimer concedes that foreigners "often purchase through a foreign corporate entity," which he adds is designed "to facilitate tax considerations in their own countries and here." But he argues vehemently that they are not driving up land prices, except possibly in what he describes as "a few isolated cases." "The well-heeled American farmers who can afford it are the ones who are driving up land prices," he maintains. And, Oppenheimer adds, only 3% of all farmland turns over each year.

What bothers dealers and managers of U.S. farmland is the new breed of promoters. "They are difficult to identify, but they

are all over Europe huckstering farmland. We assume most of them are American brokers trying to cash in on what they perceive to be a booming market in Europe" says the vice-president of a large Midwestern bank, who prefers not to be identified. "We worry about them because they claim buyers can make 10 percent, 15 percent, or more in net returns on their farm investments, and that is just ridiculous."

[p. 18425] "SOMETHING SOLID"

The bank official's point explains why large, U.S. institutional investors and corporations have generally shied away from investing in farmland on anything but a very modest scale. Bankers and agricultural economists generally agree that, depending on crops, productivity, and location, net cash returns on professionally managed farms rarely exceed 4 percent and are usually closer to 2 percent, without taking into account debt servicing and taxes. "Investors seeking fast or high gains should definitely not be in agriculture," cautions a vice-president for one of the big Chicago banks.

The European investors and their American intermediaries would be far happier if all the fuss died down. "The trend toward land investments by Europeans stems from the need for a safety factor, like gold," argues Horn of the European Investment Research Center. "These investments are not made for speculation, but forever." However, the controversy seems destined to continue simmering for the foreseeable future. Warns a staffer on the Senate Agriculture Committee which will review the GAO's probe: "We have no intention of dropping this issue until all the facts are in."

Invasion of the American Heartland
(By Christopher H. Stern)

A new breed of tenant farmer in the United States opens his eyes as the sun rises on his part of the world. What he sees, whether he is in Arkansas, Texas, or California, are acres and acres of the earth's highest-yield farmland. What he cannot see is the German industrialist in Dusseldorf, the Roman Clergyman on Lake Como, or the aging Argentinian banker, one of whom owns the farm he is about to work.

Lehndorff Vermogens Vermattung, a Hamburg-based holding company, owns 14,000 acres of choice midwestern farmland. M. Thomas Lardner, Lehndorff's general manager in the United States, says that non-resident "alien" investors want American farms. "The enthusiasm of Europeans for American farms is unbelievable."

A few foreign acquisitions have received publicity: Prince Lichtenstein's 10,000-acre farm in Texas's Red River area; the Busonis' 12,000-acre Norris farm in Illinois; the Metternich's 2,135 acres in Iowa; and the Japanese Kikamo farm in Wisconsin. However, viewed against the 340 million acres of American farmland, these purchases represent no more than a soybean in a bucket; but foreign investment in land is not limited to the acquisition of farmland. Overseas firms own 2 million acres of American forest land, hundreds of thousands of acres of coal and ranch lands, and a sizable amount of urban land. Farmland, however, is the property foreign investors are most interested in.

California is the hottest area of foreign investor activity. Amrex Corporation in San Francisco will sell $260 million worth of agricultural farms in 1977 to an assortment of Italians, Swiss, Belgians, West Germans, and Frenchmen. Says the corporation's exuberant president, Gerald Jackson, "Good farmland is selling as

fast as it's available. More than eighty percent of agricultural buyers are non-resident foreigners. We get a hundred inquiries a day from interested foreigners, and right now one of the world's biggest banks and one of the biggest investment houses are standing by with fifty million dollars of foreign capital to invest in farmland."

In New York City, Daniel Bodini, who speaks three languages, handles Eastdil Realty's foreign investors. Last year he sold 200,000 acres in the American West. This year he will sell more than twice that amount. But although other real estate companies and brokers also claim large sales to foreigners, the industry's consensus is that the big banks — particularly Northern Trust and Continental Illinois in Chicago — are doing the most spectacular business everywhere in the country.

"Foreign investors feel comfortable dealing with a bank," explains broker Davis Martin. "One hundred out of one hundred aliens who actually come looking for a U.S. farm begin by going to Northern Trust, and afterward eighty of them wander down the street to Continental." Though banks release no information, citing the fiduciary relationship they have with their clients, Northern Trust's 1976 annual report records 460,000 acres managed in 35 states. "Right now the banks couldn't be doing more farm business," says one successful Chicago broker, "and even if they've been in the business for twenty years, you can bet the overwhelming majority of their holdings are foreign because domestic owners have many better ways to manage their farms."

Davis Martin has good reason not to disparage the banks. In the Arkansas and Missouri river bottoms and in the Mississippi delta, he has handled 30 transactions worth $12 million. A competitor, Oppenheimer Industries, which sold $60 million in farms from 1974 through 1976 and will do $40 million in 1977 alone, has handled 15 to 20 farms in that region. "Foreign owners weren't too familiar with our temperate climate at first," drawls slow-talking, fast-closing broker Vardeman Moore, of Mississippi, "but they're warming to it real fast. There's a virtual land rush down here."

Foreign interest is also high in southwestern and midwestern states, but there are simply not enough large quality farms being put on the market. Henry S. Miller and Company and Interstable of Dallas each sold 15,000 acres to foreigners in 1975 and 1976. This year, they say that due to the lack of big farms they have made no sales. A few farms remain available, and foreign investors are snatching those up. Broker Fred Smith has handled 20,000 acres in the Red River area, and two-thirds of his business comes from foreign investors. San Antonio's Pleaz Naylor knows of 75,000 acres bought by foreigners in northwest Texas, but he agrees there are "a lotta lookers and little land." Complains one exasperated Chicago banker, "We can't begin to locate enough properties to please our foreign investors."

There are many reasons why foreign investors are buying American farms. "My clients are old rich families, disenchanted, nervous, or just scared out of their minds," notes Reed Oppenheimer of Oppenheimer Industries. "Many of them have had land in their families for a thousand years. They say, 'When Napoleon came, when the Prussians came, when the jewels were sold, we survived as a family because of the land.'" Brokers concur that foreigners want to salt away a place for themselves and their children and grandchildren because they fear Communism and consider America the strongest remaining bastion of free enterprise.

In a report to Congress, John Timmons, a professor of economics at Iowa State University, and Charles Curtiss, Distinguished Professor of Agriculture there, outlined the complex of incentives that are drawing foreign investors to U.S. farmland. They cited the hedge against inflation provided by the relative stability of U.S. prices and farming cost; the hope that investments in U.S. land will offer a refuge against land reform and political disorders abroad; the expectations of capital appreciation due to skyrocketing land values (witness the steady 15 to 35 percent annual rises since 1972); the tax advantages and natural advantage (access to food, materials, and farming technology) of investing in U.S. land; the fact that in terms of income and of capital appreciation, U.S. land safely balances investment portfolios; and the idea that — beyond the satisfaction, prestige, and psychic value of owning

farmland in the United States — such investment may give them control of strategic resources and provide them with a base of economic and political power within the country.

Though the incentives are well-known and heavy investment is apparent, scant information exists as to the magnitude or locations of foreign ownership. This is because land-related public records, traditionally kept at the county level, are not a practical device for disclosing who owns what and where. And since market advantage runs with secrecy, real estate people are unwilling to provide much information. By and large, brokers deal and do not tell. For example, Michael Hirsch, vice-president of Amnivest Corporation in New York City, admitted he had sold 25,000 acres of farmland to foreign investors — but quickly added that Amnivest was no longer interested in making farm acquisitions for aliens. Later, two independent brokers described being called in to an Amnivest because "the company heads are extremely anxious to locate farms for foreign investors."

The foreign investors themselves insist on anonymity. Some risk prison penalties for taking large sums of money out of their countries. Others fear that being publicly identified as persons of great wealth will make them targets for criminals and political zealots. A West Coast broker told of visiting an elite Spanish hunting club where the men had hunted together for 15 years — "yet not one of them knew that each of the others was my client. They just don't talk about it."

Silent purchases are facilitated by institutionalized investment vehicles. Much of the foreign money passes through either Credit Swisse or Deutsche Bank; through Bermuda, Bahamas, or Netherlands Antilles corporations if the source is Latin-American or European; or, if the source is Asian, through Hong Kong or Taiwan corporations. The American financial intermediaries used most often are Continental Illinois and Northern Trust. Transactions are rarely conducted principal to principal. In one deal for a 2,500-acre Kansas farm, an unnamed West German investor contacted a Canadian realty firm, which contacted a Wyoming broker, who contacted a Chicago bank, which employed a statewide Kansas broker, who in turn found a local broker. As Tom Martin, president of the Anchor Mutual Investment Fund, says of

the tangle of intermediaries, "Ten years ago a guy sitting in Frankfurt would've had trouble making a buy in total secrecy. Now it's a snap of the fingers."

American reaction to the unmonitored alien ownership of U.S. farmland varies. Businessmen stress the absolute prerogative of the free market economy. They point to the significance of creating a truly international world economic order, of maintaining an international cash flow, and of the tremendous value of American land investments abroad. "The internationalization of the world is as inevitable as it is necessary," intones broker Philip Dub, "and capital is the blood of the world's body, so it has to flow freely."

The real estate brokers argue that the hostile reaction of many farmers is xenophobic or, more bluntly, racist. After all, they note, a mere 3 percent of American farms change hands each year, and farmer-to-farmer sales account for 80 percent of all transactions. At this rate, how can foreigners ever own more than a sprinkling of American farms?

Farmers reply that foreign investors have collided head on with them and with their [p. 18426] farming communities. In the first place, they say, the unlimited capital resources of alien investors have been pitted against the farmer's instinct for expansion in what amounts to an unfair dollar dogfight. "I waited thirty-five years for my neighbor to die so I could buy his farm," says Iowa farmer Mike Degas. "When he did, it cost me an arm, a leg, and the shirt off my back."

The combined effect of this expansionist instinct and of agricultural technology has transformed the basic unit of rural communities from the small family-owned farm into the large family-owned farm. Today's corn and soybean operator, for instance, works an average of 1,000 acres, twice as much as he could cultivate 10 years ago. Farmers are very sensitive to the decline in the number of farms (from 4 million in 1960 to 2.8 million in 1976) and to the decrease in the farm population (from 15.6 million in 1960 to 8.9 million in 1975), for they fear a concentration of ownership. Ten years ago, the size of an average farm was 210 acres, in 1977 it is 310 acres. Any investor, therefore, who

threatens to further concentrate farm ownership is naturally viewed with hostility.

Foreign investors not only concentrate farm ownership but operation as well. Once a foreigner purchases a farm, an independent management service — Doane's of St. Louis, Oppenheimer's of Kansas City — or a farming subsidiary of a bank is hired. These managers then employ area farmers who, because they are already farming large land tracts, possess sophisticated farming techniques and expensive equipment. In the event that an alien's acquisition lies in a newly developed area where large-scale farming has not been practiced, an experienced farmer from a different county or state is brought in.

Local farmers are angered by the fact that absentee foreign owners are not civic-minded. Virginia farmer Ace Rudder notes that "foreigners force out people who were on the bank board and church board. These people supported local businesses while foreigners buy cheap from big dealers. In fact, the only small business growing around here is the farm brokers. And foreigners don't practice conservation, 'cause it's money they have to spend, and when it's not your living, people have short arms and deep pockets."

As to the charge of farmer racism, Harold Dodd, president of the Illinois Farmers Union, replies: "We are not against the foreign investor per se; we are against any large outside nonagricultural interests owning farmland. The biggest contributory factor to our being able to outproduce any country in the world [on the average, an American farmer feeds 57 people, a Soviet farmer feeds 7] is the structure of the family farming system, which has been a hallmark of our country since its inception."

Indeed, according to the U.S. Department of Agriculture, young families have been returning to the farm in sizable numbers. In the period from 1970 through 1975, the number of persons between the ages of sixteen and thirty-four who were self-employed in agriculture increased by about one-third over the preceding five-year period. Older farmers hope these young people will foster the regeneration of the smaller family farm, but they worry that the unlimited resources of foreigners will make it

impossible for young farmers to buy quality farmland at reasonable prices.

Politicians regard foreign interest in U.S. farmland in terms of politics at home and of America's position in the world. "To date," says Iowa congressman James Leach, "statistics indicate foreigners probably do not own incredible quantities of American farmland, but the trend pointing violently in that direction potentially endangers our nation." There is a general feeling that the emergence of an international economic order might promise greater world peace and prosperity, but as long as nations regard one another with the evil eye of self-interest, each — including the United States — had better guard its precious resources.

The "politics of food" aggravated by a desperate world food shortage is destined to become a critical international issue. American agriculture provides a balance-of-payments cushion for domestic politics in the United States as well as political leverage in international relations. The Soviet Union, Japan, and other industrial nations cannot reduce agricultural imports without dramatically affecting their food supply and their political stability. Thanks to the supremacy of the agricultural sector, the United States can always curtail imports in the event of foreign exchange difficulties. More than its thermonuclear power, America's agripower makes it a desirable ally and a force in the world.

Many states have statutes intended to prohibit or limit alien investment in farmland. At the federal level, there are three recently passed laws that are intended to facilitate the gathering of information about foreign investment. In the words of Senator Daniel Inouye (Dem.-Hawaii), "The lack of a national information base and of adequate data on agricultural land ownership have been recognized by the Congress . . . ." But as Washington tax lawyer Paul Toulouse comments wryly, "I can't see the ropes for the loopholes in any legislation concerning foreign land investment; it's just too easy to veil ownership with intermediaries, local trusts, or corporations."

It is not reassuring to hear lawmakers and others express concern about being blindfolded by a lack of information at a

policy crossroads. As Economic Research Service economist Gene Wunderlich says, "Land has sufficiently unique qualities to require separate attention in direct investment policy. America has a right, an immediate and possibly urgent right, to know who owns the land."

This is especially true in view of several ominous portents. Brokers admit they are beginning to receive numerous inquiries from farmers who want to sell to foreign investors because these buyers pay 40 percent down and in fact prefer to make all-cash purchases. (One retired broker in Arizona, a state that strictly prohibits alien ownership, says he might play a little less golf so he can respond to the inquiries he is getting each week.) Many real estate companies formerly unequipped to handle foreign investors are now feverishly preparing to enter the market. One particularly troubling sign is that in the past six months Amrex's Gerald Jackson, among others, has noted the first feelers from Middle Eastern holders of petro-chemical dollars seeking American farmland.

Even without new real estate brokers and an inflow of OPEC money, foreign interest in and acquisition of American farmland is like a luxury car accelerating powerfully and noiselessly. The incentives, the mechanisms, and the capacities for investment feed the momentum. In a few decades of harvesting, if no limit is assigned, foreign investment in U.S. farmland could eclipse American ownership. Then American agriculture, the nation's single greatest source of power, would pass from the hands of American citizens.

Mr. CLARK. Mr. President, the potential impact of this tax treaty, and others that may follow it, on agricultural States is twofold. First, if critics of the so-called arm's length method of taxation are correct, foreign investors in U.S. farmland will be able to escape significant amounts of taxation both here and abroad. This could give foreign investors a competitive tax advantage over potential domestic purchasers of land and possibly accelerate foreign and state investment here. In the process the price of land could be bid up and the degree of absentee ownership could rule.

Let me explain. As you know from the earlier remarks of my colleagues, Article 9(4) of the treaty precludes States from using the so-called unitary method of taxation on a combined reporting basis and relegating them instead to the arm's-length method of taxation.

It is argued that foreign corporations can escape significant taxation both here and abroad under the arm's-length method. For example, critics of this method point to businesses which establish corporate fronts in tax havens where they pay little or no taxes, and then juggle their books to make it appear that all of the corporation's income — including that growing out of activity in this country — was in fact earned abroad in the low tax jurisdiction. As a result of these tax savings, foreign corporations could find it relatively less expensive to buy and operate farmland here than would domestic purchasers in equivalent positions.

The second and related result which could flow from adoption of the tax policy contained in the tax treaty as written, is the erosion of agricultural States' income tax base. To the extent foreign corporations can escape State taxation under the arms-length method and to the extent foreign ownership of agricultural lands increases, the revenue impact on farm States could be significant.

Mr. President. I am not a tax expert and cannot say for a fact that preclusion of the unitary method of taxation will inevitably stimulate foreign investment in U.S. farmland or permit foreign corporations to escape taxation. I do not really think this is the time even to get into a debate about the relative merits of the unitary method or the arms-length method of taxation. My position is that where the questions as to possible impact are as substantial as they are here, a tax treaty, voted on by only the Senate, is a totally inappropriate vehicle to implement such a potentially harmful tax policy.

I urge my colleagues to join with me in supporting the reservation of article 9(4) of this treaty and opposing the treaty if article 9(4) is not reserved.

The PRESIDING OFFICER. Who yields time?

Mr. STEVENS. I would like to have some time on Senator CHURCH's time. I do not know who is controlling the time.

Mr. PELL. We are not going to use that time, so I will yield it on the proponents' side.

Mr. STEVENS. I would like to have 10 minutes.

Mr. JAVITS. Ten minutes.

Mr. STEVENS. Mr. President, for the past several months, I have, along with several other of my colleagues, urged that the Senate attach a reservation to article 9(4) of the United Kingdom-United States Treaty. At this time, I would like to outline some of the concerns that we have expressed with regard to this provision.

Article 9(4) would prohibit states from utilizing the unitary tax method in determining the tax liability of British [p. 18427] multinational corporations operating within their boundaries. The unitary method reflects the fact that all parts of a business enterprise, including its foreign affiliates, contribute to its profitability. If parts of a business are inter-related, such as drilling and marketing of a multinational oil company they are treated as a unit. The total income is apportioned to the States and countries according to the percentage of the company's business done in each. The percentage allocation is typically determined by means of a three-factor formula which includes property, payroll and sales. To determine its income attributable to a particular State, a corporation will construct as many fractions as there are factors, each representing the percentage of property, sales, and payroll in each State. The courts have recognized for years the fairness of the three-factor formula.

The alternative method of establishing tax liability is the arm's length method. The arm's length method accepts the corporate structure as presented by the company. If a foreign based company has subsidiaries in several States, the arm's length method assesses taxes based on the income in a particular State. For companies with foreign operations in several States, the shuttling of income to avoid taxes is hard to detect. To insure that income is properly distributed among the subsidiaries, IRS auditors would

have to go through all transactions, invoice by invoice, to determine if they were made at genuine "arm's length" prices. This method can be used to avoid taxation and thus cost the States millions of dollars annually. My State stands to potentially lose $50 million annually from the prohibition of the unitarty tax method. The importance of the State's abilities to distinguish foreign from U.S. income is vital, not only to protect State's revenues but also to prevent foreign firms from gaining an unwarranted tax advantage over U.S. firms in the same markets through their ability to shift U.S. income overseas or to States with lower tax rates. As multinational commerce grows, the ability of the States to deal with this problem becomes even more important. The arm's length approach creates a tax preference for foreign based firms and closes future options in the tax enforcement area.

Currently 23 States utilize the unitary tax method to some degree, and increasing numbers are adopting it as general policy. Many States find this approach favorable in its simplicity and its effectiveness in preventing tax avoidance. Even some corporations prefer its utilization, such as Exxon operating in Alaska. Whatever the deficiencies of the unitary approach, the fact that 23 States find it a desirable tool undercuts any justification for its prohibition. Let the States be the judge of which is the most appropriate method.

One of the major arguments against reservation is that it would jeopardize the entire treaty, one that could bring substantial revenues to the U.S. Treasury. According to a study conducted by the Joint Committee on Taxation, however, this is just not the case. The Treasury claims that the United States will greatly benefit from British concessions. In fact, article 9(4) is said to have been included in the treaty in return for article 10, which provides tax refunds for U.S. individuals and corporations that invest in the United Kingdom. It should be noted, however, that only one-third of the investors are individuals so mainly corporations would benefit. Also, foreign dividends are exempt from taxation, to some degree, from 19 States so this provision would not provide revenues to these States. Another provision, article 23, declares that the British petroleum revenue tax — PRT —

will be creditable for U.S. oil companies. This means that U.S. companies drilling in the North Sea will be able to subtract their PRT straight from their U.S. tax bill, dollar for dollar. Absent the treaty, the IRS has indicated that the PRT be deductible. Article 23 would specifically make creditable a U.S. tax on profits derived from North Sea oil. At a time when congressional and administrative policy is to clamp down on the bestowal of tax credits for oil companies producing abroad, article 23 would establish these credits in a treaty where they would be beyond the reach of Congress to reverse. Further, once granted for oil companies, a chain of precedent would be set in motion and oil companies producing in places other than the North Sea would demand equal treatment.

Mr. President, I would like to bring the attention of the Senate to an editorial that was printed in last Sunday's Boston Globe. While the editorial brings to light several important concerns, I would like to mention the point it raises regarding States' rights.

Article 9(4) represents a serious limitation on State taxing power that is unprecedent in previous treaties and usurps the States' right to set up and enforce their own tax structures. This right is constitutionally empowered as a State function and allows for the establishment of an income tax that is not in violation of the commerce clause. Alexander Hamilton eloquently expressed this desirable role of the States in the Federalists Papers when he stated:

> The individual States should possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants . . . [T]hey would under the plan of the (Constitutional) convention, retain that authority in the most absolute and unqualified sense: and that an attempt on the part of the national government to abridge them in the exercise of it would be a violent assumption of power, unwarranted by any article or clause of the Constitution.

While I cannot argue that it is within the power of the Federal Government to limit that right, I suggest that a tax treaty is not the proper nor desirable medium for the exercise of this power. The States should be given the opportunity to participate in the

consideration of such restrictive action and both Houses of Congress should contribute to the dissolution of this issue.

I hope that each Member of this body will carefully review the implications of this provision and find it appropriate to support reservation of article 9(4). I hope every Senator to read this editorial from the Boston Globe and I ask unanimous consent that it be printed in the RECORD.

There being no objection the editorial was ordered to be printed in the Record as follows:

TAXING: STATE TAXATION

The advantages of lowering trade barriers and fostering international commerce have been much heralded. So too has the necessity of strengthening the ability of American states to meet the challenges within their borders. Those two objectives have come into contact in a treaty embodying a U.S.—United Kingdom tax agreement due to come before the Senate soon.

The treaty offers much to American investors — primarily multinationals — that invest in the United Kingdom including a $375 million tax refund for the years 1973-78 and about $85 million a year thereafter. The refunds would be derived by granting US investors there tax credits to offset the double taxation of business income, as both corporate earnings and dividends that are now granted British investors in their own country. But while American investors would benefit by the terms of the treaty, American states could suffer.

Embodied in the treaty is prohibition against states employing a simplified method of deriving the taxes due them from British corporations operating within their borders. Instead, they would be compelled to utilize a cumbersome accounting practice that even with the promised assistance of the U.S. Treasury might be beyond their capacities. There have been wide-ranging estimates of the potential revenue losses to the states. Ultimately, the effect will depend upon whether the United Kingdom accord becomes a model for other US tax treaties with other nations.

But whatever the impact — and Treasury argues that the net result could be an increase in revenues for some states — the

effect of the accord would be to embody in a treaty which neither the states themselves nor their representatives in the House had any role in drafting, a limitation on state taxing policies and prerogatives.

Foreign investors in the United States have every right to demand that they are taxed fairly by the states, that taxing formulas are not jiggered from place to place and time to time. Yet the states clearly have the right to establish their own fair procedures or, at the least, to participate fully if Washington constricts that right.

In light of these considerations, there is a strong movement afoot in the Senate to attach a reservation to the United Kingdom tax treaty voiding the section dealing with state taxing policies. It has the support of Massachusetts tax officials, as well as those in numerous other states, and it is a reasonable course.

Mr. STEVENS. Mr. President, I want to call particular attention to the problem that Alaska has with regard to this U.K.-U.S. treaty. As I have already pointed out, article 9(4) is a very serious step so far as Alaskans are concerned. As a matter of fact, it is nearly disastrous in terms of Federal interference with the procedures that have been adopted by my State and which, as the Senator from Idaho has stated, have won the approval of major international corporations such as Exxon. If it has not been placed in the RECORD, I ask unanimous consent that the Exxon advertisement that was run in various publications from November 1977 through April of 1978 be placed in the RECORD at this point.

[p. 18428] There being no objection, the advertisement was ordered to be printed in the RECORD, as follows:

LET'S TALK . . . AMOUNT "EQUALIZING" TAXES

QUESTION. Why are you opposing corporate income tax legislation which would change the method of taxing oil company profits?

ANSWER. Because we don't believe it's equitable to impose a special income tax system on the oil industry alone, and because the proposals would result in a sharp increase in Alaska's oil

industry taxes, which are already higher than in any other producing state.

QUESTION. But supporters of the bill claim they are simply trying to equalize the tax rate. What's wrong with that?

ANSWER. You can't "equalize" taxes by increasing them on one industry only when that industry already pays the highest overall tax rate in the state. In addition, the oil industry already pays income taxes on the same basis as any other multi-state business.

QUESTION. How does the state determine how much of a multi-state company's income is taxable in Alaska?

ANSWER. Under current law, a multi-state or multi-national corporation's total worldwide income is apportioned to Alaska by an equally weighted three-factor formula based on the percentage of the company's total property, payroll and sales in the state. For instance, if the company has 25 percent of its total property, payroll and sales in Alaska, the company pays Alaska corporate income taxes on 25 percent of its total federal taxable income — at the corporate tax rate of 9.4 percent. Variations of this same formula are used in 42 other states and the District of Columbia in calculating income to attribute to multi-state companies.

QUESTION. Would Alaska change the formula under the legislation now proposed?

ANSWER. Yes. One bill would delete the sales factor and substitute an extraction factor. Supporters of the measure ignore the fact that production activity (extraction) is measured by the property and payroll factors and that Alaska also already levies a high tax on production through the severance tax. Another proposal is a separate accounting bill. We believe Alaska's present income tax law as it is applied to the oil and gas industry in Alaska is equitable and provides uniformity with other industries and most of the other states that levy income taxes. A departure from this uniformity could result in overlapping taxation by the states.

QUESTION. Do the two corporate income tax proposals now before the Legislature have anything in common?

ANSWER. Yes, both would result in multi-billion dollar tax increases on oil companies over the life of the Prudhoe Bay field. Both could discourage future resource development in Alaska at a time when most Alaskans would rather see increased job opportunities instead of increased general fund surpluses.

MR. STEVENS. Now, we are concerned enought about this treaty with the United Kingdom, but we are even more concerned about the precedent that is being set here. In effect, the Federal Government is using its treaty power to tell the State of Alaska, and other States, what they can and cannot do with regard to the taxation of foreign corporations.

In my State it is bad enough to deal with the corporations that come from one United Kingdom, but if the same principle is applied to our relationship with corporations that come from Canada, or the corporations that come from Japan, we are going to be completely at the mercy of the Federal treaty power as it affects our relationships with foreign corporations.

Japanese corporations own or control over 70 percent of the timber production and wood products activities in my State. They own or control more than 50 percent of the shore-based fish processing facilities in my State. We tax those Japanese corporations under this same approach that is being condemned in the U.K. treaty.

We have many Canadian corporations operating in my State. As a matter of fact, the corporation that is doing the exploration on the naval petroleum reserve of Alaska, the old Naval Petroleum No. 4, is a Canadian corporation. Our present method of taxing these Canadian corporations would be condemned if this provision were extended to a treaty with Canada.

There is no reason for the Federal Government to take this step in connection with the United Kingdom unless it is setting a precedent. We see this as a step toward dealing with Japan or Germany or Canada, the major trading partners of the United States, on the same footing as with the United Kingdom under this treaty.

I think a lot of people who are proponents of this treaty ought to look at their whole card because they do not deal very much with the United Kingdom. Alaska does because of the involvement of the international oil industry in the North Sea and in Alaska on a substantial basis. But we also deal with Japan; we also deal with Germany; we also deal with Canada on a massive basis, as do the majority of the States of this Union, and in particular the eastern seaboard, where the major support for this U.K. Treaty comes from. They are the ones ~~who are going to be~~ most harmed by the extension of this principle to the corporations that originate in Canada, or the corporations that originate in Germany or in Japan.

We think it is a very, very bad precedent. The Governors of the West are united on this matter. There are some 42 States that use a portion of the approach that has been adopted by Alaska. That was pointed out by Exxon in the ad that I put in the RECORD:

The ad states:

Variations of this same formula are used in 42 other States and the District of Columbia in calculating income to attribute to multi-state companies.

We are dealing with two concepts: The foreign corporation and the domestic corporation which is foreign to a particular State. I say that the net result of this will be a massive shift in the States approach to income taxation which is going to disrupt the total income picture of international corporations more than this one approach, which has been acceptable to 42 States.

It would not be utilized, Mr. President, in 42 States and the District of Columbia if it had been totally unacceptable to those people who are involved in the multinational business. But I feel that what has happened here is that someone has found a way to get some of these impounded funds from the United Kingdom back to the United States, and using that as a carrot, and using the treaty power of the United States, the Federal Government is invading States rights.

It is invading the right of a State to determine how to tax nonresident corporations. The precedent will come home to haunt

the very people, including my good friends from New York and Rhode Island that are managing the proponents' side of this treaty. It is a mistake; and I predict I will live to see the day, as a Senator, when this concept is extended to Canada, Japan, and Germany, and the very people who are arguing for it now will argue against it.

If that day every comes, and this treaty should happen to be approved tomorrow, I hope to be able to add some kind of a provision which declares this treaty null and void, because it embodies a concept which, as far as the national policy of the United States is concerned, and the relationship of the Federal Government to the sovereign, independent States, is wrong.

I do not know what some of us are going to do about it because there do not appear to be enough States interested in the relationship with the United Kingdom. When it comes to Japan or Germany, though, there will be interest, and when it comes to Canada there will be interest, because then it will involve the automobile industry, the steel industry, and some more vital industries. So, while I anticipate losing tomorrow, I want to tell the people of this country it will not be for long. When this treaty concept is carried into the relationship with the major trading partners of the United States, it will be reversed, and I think we can rest assured that the country will come to its senses, and that the United States, at the Federal level, will stop interfering with the taxing powers of the States.

Mr. PELL. Mr. President, we have heard some exceedingly cogent and well-thought-out speeches in opposition to article 9(4) of the United States-United Kingdom Tax Treaty. I have the greatest regard for our colleagues who advocate reserving on the article. There are, however, a couple of points we should examine.

First, let us look at the unitary tax system. We agree it is constitutionally legitimate. We are aware that it is being employed at this time in three States — California, Oregon, and Alaska — and is being contemplated for use in other States.

But even though it is compatible with our Constitution, it does, I think, have a hint of unfairness about it. For example, let us take

the hypothetical case of a British company which has a chocolate manufacturing plant in Africa and has a razor blade company in California. The razor blade company in California is doing very badly; the chocolate factory in Africa is doing very well.

Under the unitary tax system, California would be empowered to levy a heavy tax on the razor blade factory even though it was actually losing money. On the other hand, under African [p. 18429] tax laws, we might find either that the chocolate factory was paying excessive taxes or that it was exempt from taxation. The point of this example is to demonstrate the under the unitary system, the taxation is not being levied where the business is created.

I agree with the proponents of the treaty that the British refund of the advocate corporation tax provides an instant windfall by nature of its retroactive application. Personally, I am surprised by the magnitude of the British concession, but speaking as an American Senator, I am delighted with it, because one cannot regret, but rather must be pleased, when American subjects, be they corporations or individuals — and I recognize that two-thirds of the beneficiaries of the retroactivity will be corporations — benefit this way from a windfall. Eventually, it assumes to the good of America, and it must be remembered that there will be increased taxes levied on these retroactive tax rebates.

The question has been raised as to whether there have been other treaties in this regard that affected the taxing powers of individual sovereign States. I think there have been. My understanding is that the 1959 Friendship, Commerce, and Navigation Treaty with France specifically prevents State taxation of French companies except regarding properties located in such States, income or profit derived from activities within the State, or business which French companies do in that State.

This treaty pointed at directly the same problem, and was approved in 1959. Moreover, I think that if one examines the federalist papers, and contemplates the early days of our constitutional hearings, one must realize that our Founding Fathers knew exactly what they were doing when they pointed out that treaty law dominates State law. What was valid then is valid now.

In connection with the benefits, I think we should bear in mind that certainly there are benefits and losses. Of the three States that incur losses, California will incur the most, But let us look at what the benefits are as well.

On balance, I think of U.S. nationals, be they citizens, be they corporations, or be they — and I have had a good deal of mail on this subject — the spouses, or spice, whatever the plural is, of American citizens living in the United Kingdom; they have been very unfairly treated in the past, and this treaty makes their treatment fair.

I think when you look at the general balance sheet, and realize the increased investments that will probably result from the treaty, and the taxes that will be levied on them, you will see that this treaty is very much to the benefit of U.S. citizens and corporations, and there is nothing wrong with that.

Mr. President, I ask unanimous consent to have printed in the RECORD at this point a table giving an approximate idea of the concessions and the gains from this treaty. I think a perusal of that table will convince any of our colleagues who reads the record of this debate that the United States gains substantial benefits from this treaty.

There being no objection, the table was ordered to be printed in the RECORD, as follows:

Proposed U.S.-U.K. income tax treaty: U.S. benefits and concessions as compared to present treaty.[1]

U.S. BENEFITS

1. The U.K. will refund the full ACT to U.S. portfolio investors. Payments about $25 million per year. Negligible Federal revenue impact: some state revenue gain.

[1]Table does not refect concessions and benefits in present treaty, as compared with internal law, which are not changed in proposed treaty, e.g., exemption of interest and royalties from withholding in source country.

2. The U.K. will refund one-half of the ACT to U.S. direct investors. Payments about $60 million per year. Federal Revenue gain $10 to $15 million: some state revenue gain.

3. ACT refunds are retroactive to 1973 for portfolio investors and to 1975 for direct investors. Total U.K. payments in 1978 for the retroactive period will be $375 million revenue gain for retroactive period $50-75 million.

4. The U.K. has agreed to apply the principles in the new U.S. income allocation regulations (section 861). Possible revenue gain.

5. The treaty removes discrimination against U.S. women married to U.K. domicilairies. Slight revenue gain.

6. U.K. entertainers subject to U.S. tax if gross remuneration exceeds $15,000. Minor revenue impact.

U.S. CONCESSIONS

1. The U.S. will credit the U.K. Petroleum Revenue Tax (PRT). Revenue effect negligible.

2. States are limited in the application of unitary apportionment to U.K. owned corporations. States estimate state revenue cost at $30 million. Treasury estimates little or no cost to states.

3. The U.S. will exempt British insurance companies from excise on premiums. Little basis for revenue estimate: probably well under $25 million for the 1975-1978 period and $5-10 million for 1979.

4. The U.S. will reduce withholding rates on dividends to U.K. parent corporations. Revenue cost 1975-1978 about $60 million, $16 million per year thereafter.

5. U.S. entertainers subject to U.K. tax on gross remuneration exceeds $15,000. Minor revenue impact.

6. U.S. agreed that U.S. citizens resident in U.K. should be treated under the treaty as U.K. residents. This will have no U.S. revenue impact.

Mr. PELL. Finally. the State that presently benefits most from the unitary system of taxation, California, has its Governor and its two Senators squarely in support of this treaty. Why? Because they do not see it with the narrow blindness of the taxing authority alone, or the Franchise Tax Board, as it is called. They see it through the wider perspective of Senators or a Governor and are looking at the overall benefits to that State. They hope and believe — or they would not take the position they do — that the application of this treaty will lead to the benefit of California.

For all these reasons, on balance, I believe it is to the advantage of the United States to move ahead with this treaty and not regret that a windfall may occur.

Let us say that a windfall does occur. In the United States, when anyone has a windfall, we should all say hurrah, as long as taxes are paid on that windfall. Lord only knows U.S. citizens and corporations are taking a beating, taxwise, throughout the world today.

Mr. JAVITS. Mr President, I yield myself 10 minutes.

The PRESIDING OFFICER (Mr. Matsunaga). The Senator from New York.

Mr. JAVITS. Mr. President, I ask unanimous consent that floor privileges be extended to Jon Fleming of Senator Cranston's staff and Jacques Gorlin of my staff.

The PRESIDING OFFICER. Without objection, it is so ordered.

Mr. JAVITS. Mr. President, I believe we have debated this subject as far as we can tonight, but I would like, before we end this part of the debate and go over until tomorrow, to correct certain impressions which may have been created by the debate, so that Members who may read the RECORD will have a complete rather than an incomplete record.

In the first place, Mr. President, the question has been raised as to the revenue loss to the States now using the unitary method of taxation.

Let us remember, and I again repeat, that there will be taxes paid on the $375 million which will come in to U.S. investors, and that thereafter there will be a benefit at the rate of $85 million a year, which is also very appreciable.

As to the losses to individual States, Senator PELL and I have already inserted into the RECORD the telegram of the Governor of California, which shows that as far as they are concerned, we are talking about $15 million or $20 million, and they are by far the biggest State. They are confident they will more than make up for that loss of revenue through an improved investment climate in the State.

Aside from that, I refer to a letter dated February 24, 1978, addressed to Steven Emerson, of the Subcommittee on Foreign Economic Policy of the Senate, by the international tax counsel of the Office of the Secretary of the Treasury, H. David Rosenbloom, I wish to highlight it.

In any event, in assessing the estimates made by California, Alaska, and Oregon, please bear the following facts in mind. If one assumes the existence of a 9 percent corporate rate (the California rate), an estimate of a $30 million loss in revenue means that approximately $333 million of income is escaping taxation. Since Article 9(1) of the proposed Convention allows states to use the same arm's-length method of determining transfer pricing that is available to the Federal Government, the above-mentioned $333 million must be escaping not merely state taxation, but federal taxation as well.

After some calculations he goes on in the letter to make it clear that even the estimate of loss of $30 million of revenue is rather high. Therefore, I submit that that is a very substantial bit of evidence backing up what I have said, especially in view of the statement of the Governor of California that it means $15 to $20 million to California which, in relation to the other two States, Alaska [p. 18430] and Idaho, is larger by 20 to 1 in terms of population and, therefore, in terms of the business that is likely to be done in that particular State.

The other thing that I wish to emphasize is that the arm's length method which most States use is an entirely appropriate and fair method of taxation.

Mr. President, I ask unanimous consent that a rebuttal prepared by the Treasury Department on that subject answering the charge that the arm's length method imposes more burdens on the taxpayers than the unitary method be printed at this point, in the RECORD, together with another Treasury rebuttal to the charge that the unitary method is the most reasonable and equitable approach to allocate income.

Mr. President, that is just not so. These statements, which are very professional, make this very, very clear.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

The Arm's-Length Method Imposes More Burdens on Taxpayers Than the Unitary Method

Rebuttal: The unitary method as applied internationally required foreign affiliates of companies doing business here to keep records and books in English and in U.S. tax concepts even if these affiliates never do business in the United States or never engage in a business transaction with a company that is operating here. Thus, all foreign affiliates have significant burdens imposed upon them by the unitary system. In sharp contrast, the "arm's-length" method — the method used by the Federal government domestically and internally and the method used by most states internationally — only involves a foreign affiliate when that affiliate engages in a business transaction with a company doing business in the United States. And that foreign affiliate may only be concerned with U.S. record-keeping to the extent of its transactions with that U.S. affiliate. A foreign affiliate that has no office here but brings from or sells to a related company present here need not, under the arm's-length method, even produce its books and records less it appears to the tax authorities that a transaction does not clearly reveal income in contrast, the unitary system requires the production of foreign books and records by that foreign affiliate in all cases. In short, it is clearly inaccurate to

state that the unitary method imposes fewer burdens on taxpayers that does the arm's-length method. In fact, the opposite is true.

The Unitary Method is the Most Reasonable and Equitable Approach to Allocate Income.

Rebuttal: The unitary method has certain advantages when used domestically by the states. Economic conditions in the United States are comparable; valuations of sales, property and payroll do not vary greatly between the states. This is not the case internationally. The cost of labor and property is substantially lower in developing countries than, for example, in California, but the three-factor unitary apportionment formula operates as if the costs were the same. Due to such differences in costs, plus a lack of uniformity with respect to foreign and state rules on allocating income, the unitary system almost assuredly creates substantial distortions and double taxation of income when appeared in the international arena.

Mr. JAVITS. I would like to read to my colleagues from a letter that Assistant Secretary designate Ulrich answering the concerns about the effect of the treaty on the ownership of U.S. farmland:

The proposed treaty does not in any way create a tax preference for foreign ownership of U.S. farmland. The proposed treaty contains no provisions specifically addressed to the taxation of farmland. The treaty does provide in Article C that all U.S. real property income is taxable in the United States under normal Federal tax rules. This would include income derived from farmland. The treaty most certainly would not prevent the states from taxing farm income.

As explained in Secretary Blumenthal's letter, there are a few limited situations where pursuant to Article 9(4) of the proposed treaty states may not use the so-called unitary method in taxing profits. At the present, there are only three states that would be affected by Article 9(4) — California. Alaska and Oregon. In the limited situations where the unitary method of taxation may not be used, the states are allowed under the treaty to use the arm's length method of controlling prices in transactions between related parties. There is a wide market for agricultural products and

it is, therefore, very easy to obtain arm's length prices and to avoid any possible shifting of profits. Moreover, Federal audit information is available to state tax authorities for the purpose of determining an arm's length price.

We understand that the concern with respect to the taxation of farming profits is primarily directed at Japanese interests and not the United Kingdom. Of Course, the proposed treaty with the United Kingdom does not in any way relate to Japanese investment.

Another argument with respect to the treaty's impact on farmland is that the treaty would somehow prevent the states from requiring that farmland be owned by domestic corporations or domestic persons. This argument is totally incorrect. The proposed treaty does not contain any rules affecting state laws with respect to the rights of foreign persons to own U.S. farmland or any other type of land. Although there is a non-discrimination article in the proposed treaty, this article only applies to Federal and state laws with respect to *taxation*. The non-discrimination article in the proposed treaty is the same in this respect as non-discrimination articles already contained in our current treaty with the United Kingdom and sixteen other U.S. tax-treaties. None of those treaties require the states to alter any rules with respect to land ownership.

Mr. President, I think it is very important to address oneself to the attempt to turn down the whole treaty through the insertion of this reservation, which is an indirect rather than a direct way of trying to defeat it directly.

It seems to me that we must be very cautious in arguing against the free flow of international investment. The encouragement of investment in this country and the investment by our nationals in other countries represents the fundamental strength of our world. That is the way in which developing countries can be developed; in which industrialized countries can be helped through difficult periods such as Great Britain has had.

Furthermore, the provisions in the treaty are extremely limited rather than broad, which I must again emphasize at this point. The treaty does not prohibit States from applying unitary taxa-

tion. It does not affect unitary taxation of U.S. corporations, nor does it affect foreign corporations controlled by U.S. persons, or even by persons from countries other than the United Kingdom, nor does the treaty prevent the application even of unitary taxation to the operation of foreign corporations which do an aggregate business in the several States of the United States.

Indeed, unitary taxation may be applied freely where the universe to which the tax is directed is a universe of business done within the 50 States, within the United States itself. Therefore, in view of the limitations and in considering what is at stake, the amounts which are involved in lost tax revenues to the individual States which use this method, appear to be minor. In view of what we are getting back in terms of retroactive and future payments, and the non-discrimination against the U.S. directed portfolio investments, it seems to me that the treaty represents a very sound arrangement in the interests of the United States and the business system of the United States. It ought to be ratified, as indeed it was recommended by a 2 to 1 vote in the Foreign Relations Committee on this very issue when exactly the same arguments which we have heared here on the floor were made.

* * *

Exhibit 36D

[EXCERPT FROM CONGRESSIONAL RECORD]

[p. 18651] EXECUTIVE SESSION

TAX CONVENTION WITH THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND — EXECUTIVE K, 94TH CONGRESS, 2D SESSION

Mr. ROBERT C. BYRD. Mr. President, I ask unanimous consent that the Senate now go into executive session to resume its consideration of the United Kingdom Treaty.

* * *

Mr. HAYAKAWA. I thank the assistant minority leader.

Mr. President. I rise today in support of the United States-United Kingdom Tax Treaty which is now before the Senate.

[p. 18652] Some of my colleagues in this Chamber may not be aware that I was one of the early supporters of this treaty. Actually I supported it at a time when not only my senior colleague from California but also Governor Brown of California opposed this treaty. I am happy to see today that both gentlemen in the meantime have changed their position and are now supporting the treaty.

The initial opposition of my State to the tax treaty was based on a statement by the Franchise Tax Board of California — that its implementation would entail an annual tax loss of $120 million. This is an argument that never convinced me.

As it turned out the figure itself was exaggerated. Moreover, the tax board chose to disregard the obvious; namely, that a more reasonable tax would act as a powerful incentive for foreign-owned multinational corporations to invest in California or to expand their existing investments. To put it in simple terms, the California Franchise Tax Board was million-wise and billion-foolish. It disregarded the tremendous economic uplift to California in the form of increased investments, payrolls, purchasing power, and therefore taxes which an influx of foreign-owned companies would provide for California. Unfortunately, the

Franchise Tax Board's arguments neglected long-term considerations.

My emphasis on the opportunities which the unitary tax system eliminates is based on considerable evidence. Naturally I did not have the possibility of conducting a worldwide survey. But I had numerous talks with the Japanese-American Trade Council which strongly supports my point of view. Moreover, the California First Bank, which is the California branch of the Bank of Tokyo, had the following to say on the subject:

Your support of Article 9, Paragraph 4 of the pending US-UK Tax Treaty, will substantially assist the many California firms, such as California First Bank, which are presently being unduly burdened by the combined reporting (unitary) method of tax assessment as presently administered by the California Franchise Tax Board.

Should you have the opportunity to represent the interests of the State of California, you may feel free to bring to the Senate's attention a significant point relative to California First Bank, the State's eighth-largest bank.

Arbitrary administration of the assessment method may jeopardize the interests of our some 3,000 plus minority shareholders in the U.S., whose equity may be reduced by assessments based not on our California income, but on the worldwide income of our parent bank in Japan.

I also received a supportive letter from the Japan Traders' Club of Los Angeles which explains the position of the Japanese business community:

In behalf of Japan Traders' Club of Los Angeles, a nonprofit California corporation consisting of 280 United States subsidiaries, branches, and representative offices of major Japanese corporations, I would like to express my grave concern about Unitary Taxation in the State of California.

As you know, many Japanese corporations have already invested substantial amounts of funds in California. At the time, our member corporations were not aware of their intention to apply the Unitary concept to such a degree.

I strongly feel that Japanese investment in the United States should increase in order to create more employment in this country and, at the same time, help to offset a part of the trade imbalance between the United States and Japan.

We are willing to pay our fair share of corporate tax that relates directly to our United States operations. However, under this Unitary Taxation, world wide operations of the entire corporate group of companies both in and outside the United States are taken into account. The impact of this method of taxation on our member firms especially as it is exerted retroactively for 4 years is indeed severe.

If this state, which is geographically advantageous as a part of the Pacific economic basin of Japan, continues to practice the concept of Unitary Taxation, it will result in the impeding of Japanese investment in the United States at her gateway.

We are hopeful that through your good offices you will be able to emphasize to the policy and lawmakers in the Federal and State governments that such a taxation method should be eliminated.

I wish to add that this matter of a trade imbalance between the United States and Japan is a matter of great concern to Japanese businessmen, both those in Japan and those Japanese businessmen doing business in the United States. I, as my colleagues know, was in Japan and I heard this both from the Japanese people themselves and representatives of the Government and also from businessmen in California. They are very, very eager to redress this matter of trade imbalance.

In Japan, incidentally, firms like Nissan Motors, which manufactures the Datsun automobile, Toyota, Sony Electronics, the Honda Motor Co. — these are all companies that either are contemplating enlarging their present facilities in California, as in the case of Sony, or in the case of Honda, Nissan, and Toyota seriously considering putting in assembly plants in California.

These are all people who in one way or another will be doing business in the United States, and the unitary tax system is a formidable barrier to them, as told to me personally by the heads

of these organizations.

Mr. President, I shall make some brief comments about the so-called unitary tax system itself. It is covered in article 9(4) of the treaty.

It is well established that in appropriate cases the business of a single corporation may be treated as unitary in nature and that the total income of such a corporation may properly be apportioned under a formula that fairly attributes a proportionate part of the corporation's income to a particular State.

When applied in a multicorporate setting, however, the "unitary business" doctrine of combined reporting requires that a corporation with a business location in the State includes in its apportionable tax base not only the entire income of such corporation within the State, but also the income of such of its worldwide affiliates as are found by the State to participate with the corporation in a single business unit.

This broad approach to corporate taxation can in effect result in taxation by the State of the income of corporations that have no real contact or connection with the State. Since this tax is not applied by all States, the "unitary business" concept can result in more than 100 percent of a company's income being subjected to State taxation or can result in a company paying tax on an allocable portion of the entire income of another corporation, even though there is not complete unity of ownership between the two corporations, for an example, the subsidiary is only 51-percent owned. Suppose the Japanese firm or the British firm is 100-percent owned by the Japanese or Britain but the subsidiary is only 51-percent owned and the other 49 percent is being owned by American investors. This is the kind of illogical situation that results.

Finally, as it has been interpreted by a few States, such as California, the "unitary business" concept results in the apportionable tax base of a corporation with a business location in the State, even though the activities in the State in no way contribute to the earning of such foreign income.

As indicated, I am opposed to the application of this unitary

business doctrine to multinational corporations. In my opinion, it impinges on the foreign relations of the United States.

Opponents of the treaty argue that the provisions in the proposed treaty are a flagrant usurpation of — the State's — legislative powers. In reply I cite the Foreign Relations Law of the United States, which in paragraph 117, dealing with the scope of international agreements, has the following to say:

(1) The United States has the power under the Constitution to make an international agreement if

(a) The matter is of international concern, and

(b) The agreement does not contravene any of the limitation of the Constitution applicable to all powers of the United States.

I also would like to cite from the remarks of the eminent lawyer Charles Evans Hughes when he spoke in 1929 before the American Society of International Law.

I take the view which I understand to be that of the Supreme Court that this is a sovereign nation; that the states, in relation to foreign affairs, are not sovereign states; that if this nation exercised its sovereign power in regulations to other nations it must be done through the exercise of the treaty-making power and in that relation there are no states, there is but one country.

In the past, there were some cases when the treaty-making powers of the United States were challenged by individual States, but the Supreme Court ruled in favor of the United States.

Mr. President, my final comments pertain to article 10 — dividends — and article 23 — elimination of double taxation — of the proposed treaty. There can be no doubt that if article 9(4) should be eliminated, the United Kingdom would insist on renegotiation of the treaty. Like many treaties the document before the Senate is based on the principle of "Give and Take." The dividend provision of the United States-United Kingdom Tax [p. 18653] Treaty reflects a major concession by Great Britain. If article 9(4) fails, the dividend provision undoubtedly will also be eliminated. Let me explain.

In 1973 the United Kingdom introduced a partially integrated system under which a portion of the tax collected at the corporate level is treated — with respect to distributed profits — as having been paid on behalf of resident individual shareholders.

Under the United Kingdom system, United Kingdom corporations are subject to an initial corporate tax liability of 52 percent. When a dividend is paid, a tax called the Advance Corporation Tax — or act — is levied. This act is equal to 35/65 of the net dividend and it is credited against the corporation's regular yearend tax liability.

An individual U.K. resident shareholder pays tax not only on the dividend but also on the act paid with respect to the dividend. However, he may claim a credit against his own income tax liability for the act. If he is a "standard rate" taxpayer subject to a 35 percent rate, the credit will exactly offset his tax on the dividend income. If he is subject to tax below the standard rate, he will receive a refund of the excess of the act credit over his tax due. Thus, for a U.K. resident, the act is clearly a prepayment at the corporate level of the shareholder's tax.

However, when the shareholder is a nonresident alien, the situation is quite different. British law provides that the act must be paid upon any distribution, but there is no credit or refund allowed to the nonresident shareholder — corporate or individual.

This treatment discriminates against U.S. investors in the U.K., since for U.K. shareholders the effective underlying corporate tax rate with respect to distributed profits is just over 26 percent while, in the absence of this treaty, for nonresident shareholders the rate remains at 52 percent. This discrimination is potentially of significant dollar magnitude, and must be viewed as a serious problem. The U.S. Treasury concluded that an income tax treaty is probably the only appropriate vehicle for mitigating the discrimination.

The new U.K. system is not a unique or isolated phenomenon, but rather is likely to be the prototype for European tax systems generally. A June 1975 draft directive of the Commission of the European Economic Community calls for adoption of similar integrated corporate/shareholder tax systems by all Common

Market countries. Such a system has been in place in France for some time, and the new tax law in West Germany follows a similar approach. It is therefore, obvious that a precedent must be established early if the United States is to deal effectively in subsequent negotiations with other countries employing integrated systems.

Under the rules of article 10 — dividends — and article 23 — elimination of double taxation — of the proposed treaty, the discrimination is substantially reduced. For U.S. portfolio shareholders, the treaty provides the same credit as that available to a United Kingdom shareholder. The United States-United Kingdom Tax Treaty which is before the Senate — if ratified — will establish the necessary and terribly important precedent. In sum then, Mr. President, the economic interests of the United States clearly demand that this treaty be promptly ratified. I therefore urge my colleagues to rally in support of the treaty.

I thank the Chair.

Mr. JAVITS addressed the Chair.

The ACTING PRESIDENT pro tempore. The Senator from New York.

Mr. JAVITS. Mr. President, I yield myself 1 minute.

Mr. President, I am very grateful to Senator HAYAKAWA for this presentation: first, for the excellence of the text which has been developed and which makes a very strong case for the treaty; and, second, because the presentation is quite indicative of the man.

The State of California started, Mr. President, by being in opposition to this treaty and, indeed, the distinguished Senator from Idaho, who is sponsoring, the reservation we are now debating, cited the State tax commission of California as still being opposed to it.

But, Mr. President, both Senators from California and the Governor are for the treaty, thus I think it is fair to say the State as such supports the treaty.

Senator HAYAKAWA came to his decision after much deliberation. When we first began consideration of the treaty, even before committee hearings, he was doubtful about whether he should support this treaty as being in the interests of his State. He quickly decided to support the treaty. As in my own life, I consider the words "I am persuaded" the proudest words that I can utter, because I am not persuaded easily.

I pay tribute to him because that is what happened in this case, and it is a real confirmation, that Senator HAYAKAWA's views have been a tremendous lateral support to me in my conviction that support for the treaty was the right way to go, and I am very grateful to him for more reasons than just the normal thanks to a colleague who supports another.

I yield.

Mr. HAYAKAWA. I thank the distinguished Senator from New York for those kind words.

I might add Governor Brown underwent a similar change of heart. He visited Japan without knowing about the United States-United Kingdom tax code, and it was only after he got to Japan that he learned that many Japanese companies were unwilling to come to California for that reason, and he gradually changed his mind on the subject.

Mr. JAVITS. I thank my colleague very much.

I yield myself 5 minutes.

While we are on the problem of Treasury consultation with the States on the treaty, I would like to remind my colleagues that the State Taxing Commission of California had made a very proper complaint to the Treasury about a particular provision of the treaty in which it said it would not only protect against imposition through the misuse of the unitary tax system United Kingdom corporations, but the protection would also be extended to U.S.-controlled companies which had affiliates in the United Kingdom.

The Treasury recognized the propriety of that particular objection and, hence, negotiated a protocol, which is also before us, and

which will be voted on this morning, and the protocol corrects the very objection made by the California taxing authority.

Now, the California Franchise Board is still, as Senator CHURCH of Idaho has said, opposed. But I wish to point out that both for the substantive reasons Senator HAYAKAWA has set forth and because of the Treasury's responsiveness to their complaint which resulted in an amendment to the treaty in a protocol arrived at by agreement in 1976 there was a real and reasonable effort, I think a good-faith effort, to meet the views of California, and I think that is a very important argument in favor of the treaty.

Now, Governors generally, contrary to the impression sought to be created here, have expressed approval of the treaty.

I have before me a letter from Governor Carey of New York, and I ask unanimous consent that it may be included in the RECORD. It is dated June 16, 1978, and it is addressed to me, and it is as follows:

STATE OF NEW YORK,
EXECUTIVE CHAMBER,
Albany, June 16, 1978.

HON. JACOB K. JAVITS,
Senate Office Building,
Washington, D.C.

DEAR JACK: I understand that the Senate will consider for ratification the proposed US-UK Income Tax Treaty at the conclusion of the Labor Law Reform legislation. I also understand that you were instrumental in moving the proposed treaty to its present stage. Since it is my hope that the proposed treaty will improve the climate for investment and new jobs by multinational firms in New York, I wish to express my appreciation for your efforts thus far.

Recently, I expressed my endorsement of the proposed treaty without the article 9(4) reservation in a response to a solicitation for my support from Secretary of the Treasury W. Michael Blumenthal.

You will have my continued support for the proposed treaty as it is brought to the Senate floor for ratification.

Best regards.

Sincerely,

HUGH L. CAREY.

Mr. President, I ask unanimous consent that a letter from Gov. John D. Rockefeller IV, of West Virginia, dated March 3, 1978, may be made part of my remarks. I read that letter, which is addressed to our beloved and distinguished chairman, Senator SPARKMAN:

STATE OF WEST VIRGINIA,
OFFICE OF THE GOVERNOR,
Charleston, March 3, 1978.

DEAR SENATOR SPARKMAN: The proposed income tax treaty with the United Kingdom was signed December 31, 1975 and is presently pending ratification by the United States Supreme Court.

In earlier correspondence to both the President and your Committee, the State of West Virginia had taken the position of opposing ratification of the treaty. This view was based primarily on an analysis of Article 2, Paragraph (2)(c) and Article 9, Paragraphs (4) [p. 18654] and (5) which led us to originally conclude that the treaty would not be in the long term best interests of West Virginia.

After an extensive review and further evaluation of the treaty's provisions, I am now convinced that the treaty is deserving of my support. This change in position is attributable to the following:

(1) West Virginia was originally deeply concerned that certain treaty provisions would be expanded in the future either by treaty or legislation. The primary reason for West Virginia's opposition was that a trend toward greater federal intervention in the tax practices of the states would develop. The Treasury Department, however, recently has informed us that they have no intention of expanding the scope of the treaty in the future.

(2) We estimate that the treaty prohibition on the use of the unitary tax system would reduce corporate tax revenues by approximately $300,000 annually. However, in reviewing the aggregate impact of the treaty, I am now confident that the tax gains to West Virginia by reason of the treaty should more than offset this loss.

(3) I believe the treaty will bring needed equity in the tax treatment of United States corporations conducting business abroad.

(4) Initially, we were also concerned over our ability to vigorously enforce the arms length standard to arrive at the taxable income of separate corporations since the treaty prohibits the use of the unitary tax system. The Internal Revenue Service has recently informed us that data they have developed on arm's length pricing would be made available to state tax administrators and this should solve our problems.

It is for these reasons that I wish to state my support for the treaty and respectfully encourage you and your distinguished colleagues in the United States Senate to vote for its ratification.

Sincerely,

JOHN D. ROCKEFELLER IV.

Now that, Mr. President, is again one of the major arguments for this treaty, to wit, the need to create a better climate for the investment of funds in the United States and to improve the basis for industrial development here by other countries.

So we are putting our feet on the right road in terms of foreign investment in the United States which, in view of the terrible imbalance which we have in our payments, is extremely desirable and in the interests of our Nation.

Mr. President, unless Senator SPARKMAN wishes to yield some time, I am prepared to yield to Senator PERCY.

I yield 5 minutes to the Senator from Illinois.

The ACTING PRESIDENT Pro tempore. The Senator from Illinois.

Mr. PERCY. I thank my distinguished colleague.

I would first like to say that I think we all owe a debt of gratitude to Senator Javits for the persistence with which he has worked with the leadership to see that this treaty goes forward, and I wish to express appreciation also to our distinguished chairman, Senator Sparkman, for his leadership in this regard.

Mr. President, as the poor managers of the treaty know, I strongly supported the treaty pending before us in the Committee on Foreign Relations. We did have some opposition from the Illinois Department of Revenue and, I think, some degree of misunderstanding by some other people. I would like to state my support again at this time. I believe the treaty will bring highly favorable benefits to the United States.

The treaty will bring significant capital flows into the United States at a time when large foreign holdings of dollars are putting pressure on the value of our currency in foreign exchange markets. It is estimated that there will be an immediate payment of approximately \$375 million in U.K. tax refunds to Americans, and additional substantial refunds after that.

Furthermore, the dividend provisions in the treaty are a major favorable development in our Government's efforts to overcome the discrimination against Americans investing in the United Kingdom and in our other major trading partners who use a so-called integrated tax system similar to that of the United Kingdom.

I am aware that there has been a great deal of protest about the restriction in article 9(4) of the treaty on the application of the unitary apportionment tax system. Senator Church is sponsoring a reservation which would effectively cancel this provision. I would point out that the treaty does not prohibit the use of the unitary taxation formula per se. It does not prevent the States from using the unitary taxation method to tax U.S. corporations. Nor does it affect unitary taxation of U.S. corporations, nor does it affect either foreign corporations controlled by U.S. persons or foreign corporations controlled by persons from countries other than the United Kingdom.

Finally, the treaty does not prevent the application of the unitary formula to the operations of foreign corporations doing business in several States in our country.

What it does restrict, Mr. President, is the taxation of income of foreign affiliates with no business in the taxing State. It just says that a State may not take into account the operations of a foreign corporation not doing business in the State if the corporate group in question is controlled in the United Kingdom. As a former businessman, I can attest to the justification in the claim that this application of the unitary taxation formula is grossly unfair.

On another issue, Mr. President, I want to comment on the concern which has been expressed by some parties about the effect of this treaty on foreign investment in U.S. farmland. The fear which has been expressed is that article 9(4) will encourage foreign investment by giving foreign investors an unfairly advantageous tax position. This is certainly a serious concern in Illinois, and I am pleased that the Department of the Treasury has done a good job of setting the record straight in a statement submitted to the Senate in May of this year in behalf of the Secretary of the Treasury:

> The proposed treaty does not in any way create a tax preference for foreign ownership of U.S. farmland. The proposed treaty contains no provisions specifically addressed to the taxation of farmland. The treaty does provide in Article 6 that all U.S. real property income is taxable in the United States under normal Federal tax rules. This would include income derived from farmland. The treaty most certainly would not prevent the states from taxing farm income.
>
> There are a few limited situations where, pursuant to Article 9(4) of the proposed treaty, states may not use the so-called unitary method in taxing profits. At present, only three states would be affected by Article 9(4) — California, Alaska and Oregon. In the limited situations where the unitary method of taxation may not be used, the states are allowed under the treaty to use the arm's length method of controlling prices in transactions between related parties. There is a wide market for agricul-

tural products and it is, therefore, very easy to obtain arm's length prices and to avoid any possible shifting of profits. Moreover, Federal audit information is available to state tax authorities for the purpose of determining an arm's length price. Thus, the limited restriction on use of the unitary tax method should not permit foreign corporations to escape state taxation on U.S. farm income through artificial pricing practices.

The ACTING PRESIDENT pro tempore. The Senator's 5 minutes have expired.

Mr. JAVITS. I yield the Senator 5 more minutes.

The ACTING PRESIDENT pro tempore. An additional 5 minutes is yielded the Senator from Illinois.

Mr. PERCY. Mr. President, I urge my colleagues to support the proposed treaty and to vote against attaching a reservation to article 9(4). It is beneficial to the United States, it encourages the free flow of trade and investment, and is an important contribution to our Government's policy of promoting international economic cooperation.

Mr. JAVITS. Mr. President, I thank Senator PERCY. He is a man highly experienced in business. This tax treaty is essentially a business stimulant, and his support for it is extremely valuable.

I would also like to add this: I heard with great interest and with great respect Senator CHURCH say last night that this was a treaty for the interests of the rich people.

Well, Mr. President, we have 90 million people employed in this country; 90 percent of them are employed by American business enterprises. I fail to see how populism can fail to include the employers as well as the employed. That is the only way that jobs can be created.

I value Senator PERCY'S support for this treaty. With all respect, I think he is just as populist minded, and his area of the country is just as populist minded, as our distinguished colleague from Idaho and his region. But he has business experience and he knows what makes the merry-go-round. I value very much, therefore, his support of the treaty.

Mr. SPARKMAN. Mr. President, I yield such time as the Senator from Rhode Island may require.

Mr. PELL. Mr. President, I believe the question of the attitude of the farmers and the impact upon farms was raised by the Senator from Illinois. In this regard, I have been told that Mr. W. E. Hamilton, chief economist of the American Farm Bureau Federation, the largest farmer organization in America, has informed the various federation offices that while the federation has taken no position on the U.K. Tax Treaty, he [p. 18655] found nothing in the treaty with which he could take exception. I thought this viewpoint of the American Farm Bureau should be put into the record as they are the largest representative of the farming industry.

* * *

Mr. JAVITS: Mr. President, I yield 5 minutes to the Senator from Alaska.

Mr. STEVENS. I appreciate that, Mr. President.

Mr. President, at this point in the debate on the United States-United Kingdom Tax Treaty, I should like to provide for the record resolutions calling for a reservation of article 9(4) of this treaty, the reservation proposed by the Senator from Idaho. The resolutions were passed by the Western Governors Conference, the National Association of Tax Administrators, the National Conference of State Legislators, and the National Association of Attorneys General. I have also received letters and telegrams expressing opposition to article 9(4) unless it is subject to a reservation such as we support here. These letters and telegrams have come from the Multistate Tax Commission, the AFL-CIO, the Consumer Federation of America; the Service Employees International Union; the American Federation of State, County and Municipal Employees; the Oil, Chemical, and Atomic Workers; the International Association of Machinists; Ralph Nader's Tax Reform Research Group, the Energy Policy Tax Force; Common Cause; and the Ohio Public Interest Campaign.

Mr. President, since I have served in the Senate I have never seen an issue in which the spectrum is so broad to protect States'

rights. To have Mr. Nader's Reform Research Group together with the Consumer Federation of America and the Multistate Tax Commission, all of these union organizations, together with the national conference of all the legislators of all the State legislatures of the Nation, expressing opposition to this tax treaty unless article 9(4) is subject to this reservation, I think, ought to make other Members of the Senate think twice before they support this treaty without the reservation.

Mr. President, I ask unanimous consent that these resolutions and items be printed in the RECORD at the conclusion of my remarks.

The ACTING PRESIDENT pro tempore. Without objection, it is so ordered. (See exhibit 1.)

Mr. STEVENS. These resolutions state categorically the position of those who are most familiar with State taxation in this country.

In particular, I call the attention of the Senate to the National Association of Tax Administrators and their meeting held in Atlanta, Ga., in June of 1976, where they expressed their total opposition to this unprecedented action of the executive branch wherein the U.S. Government has, in secret bargaining with a foreign country, sought to limit our sovereign States' taxing powers.

They have sought to do so in a way that benefits foreign multinational corporations. Our domestic multinational corporations, as exemplified by Exxon, have taken the position that the action of 42 States and the District of Columbia is acceptable to our domestic international corporations. This tax treaty is designed to give solace to foreign international corporations which do business in this country.

The National Association of Tax Administrators has announced its opposition not only to this treaty but to the action of the Federal Government with respect to these foreign multinational taxpayers and urge that the State legislatures take action to express their opposition, also.

As a result of that request, in September of 1976, the president of the National Conference of State Legislatures, who is also the president of the Colorado State Senate, sent to the Foreign Relations Committee a very thoughtful letter, which contained as an enclosure the policy position of the National Conference of State Legislatures. That national conference urged Congress to delete from this treaty the provisions which would infringe upon the separate tax systems of the States and governmental units and urged us to place reservations on the treaty that would forbid the States from utilizing the unitary taxation system.

That was followed, Mr. President, by action of all the attorneys general of the States of our Union when they met in Baltimore in September 1977. I am informed that the National Association of Attorneys General unanimously opposed the provision of this treaty which would impinge upon State taxation and the rights of States to determine their own State tax policy. That, too, was followed by the action of the Western Governors of the United States when they passed the resolution which I have asked to have printed in the RECORD. They passed it at their meeting in September of 1977.

We in Alaska and, particularly, those in the West, developed the unitary tax method as being the best way to apportion income among foreign multinational corporations that do business in several States of the Union. This reservation today ought to be given support by the Senate because, if we permit the United Kingdom Treaty to be used as a first vehicle for the adoption of restraints upon States' taxing power through the use of the treaty power of the executive branch. I believe the ultimate net result will be, that Canada, Germany, and Japan, in particular, will ask for similar treatment.

When that day comes, those people who have indicated their support here on the floor for this treaty, because of the little quid pro quo of returning the stockholders' impounded dividends from the British Empire to the United States will suddenly find themselves staring at the question of whether or not we will discriminate against our major trade partners and not give the multinational foreign corporations that originate in Canada, or in

Germany, or in Japan, the same treatment we have agreed to give those that originate in the United Kingdom.

I again, Mr. President, call attention of the Senate to the broad spectrum of opposition throughout the United States as expressed by the Attorneys General, the Multistate Tax Commission, the Consumer Federation of America, the employees unions of the Government, the local governments, and in particular those that are related to the public interest task force concept that deal with taxation, Ralph Nader's group, the Energy Policy Tax Force and Common Cause.

With all of those organizations uniting in opposition to this treaty without reservation I hope that the Senate will think twice before it votes on the Church amendment.

I thank the Senator from New York.

Exhibit 1

Resolution Unanimously Adopted at the Forty-Fourth Annual Meeting of the National Association of Tax Administrators, Held in Atlanta, GA., June 16-17, 1976

Resolution Eight

Whereas, both the Executive and Legislative Branches of the Federal Government have under consideration separate proposals which would override state taxing powers and methods, and

Whereas, the Executive Branch, in total secrecy, took the unprecedented action of negotiating and executing a treaty with the United Kingdom which restricts state taxing methods, and substantially reduces the corporate tax revenues for some states for the benefit of multinational corporations, and

Whereas, the United States House Ways and Means Task Force on Foreign Source Income is considering a proposal by Representative Jones to limit states in determining the amount of income derived from state sources to the federal tax base, thereby permitting multinational corporations to manipulate their income

and defer the payment of income taxes by the corporate form through which their activities are conducted, and the geographical areas through which their activities are conducted, and

Whereas, such actions completely disregard and undermine the continuing efforts of the several states to develop a uniform approach to the taxation of multistate and multinational corporations, now, therefore, be it

Resolved, by the National Association of Tax Administrators as follows:

1. That it opposes the unprecedented action adopted by the Executive Branch in secretly bargaining away the states' taxing powers, and in particular because such action benefits only the world's largest multinational corporations which have never established [p. 18656] that they are exposed to tax on all of their income, nor that their effective tax rate is comparable to the tax rate imposed on local corporations.

2. That the National Association of Tax Administrators continues to oppose restrictive federal tax legislation with respect to multistate or multinational taxpayers; and if such legislation is mandated it should not provide preferential tax treatment for multinational corporations, nor permit such corporations to alter tax consequences by the corporate form through which they conduct their activities.

3. That each member state of the National Association of Tax Administrators request their state legislatures to enact appropriate Resolutions urging that the treaty provisions relating to state taxes be reserved, and that Congress not approve any restrictive federal interstate tax legislation.

4. That copies of the Resolution be sent to the following:

(a) President of the United States;

(b) Governor of each state;

(c) U.S. State Department;

(d) U.S. Treasury Department, International Tax Section;

(e) U.S. Senate Committee on Foreign Relations;

(f) U.S. House Committee on Ways and Means;

(g) U.S. Senate Finance Committee;

(h) U.S. Joint Committee on Internal Revenue Taxation; and

(i) U.S. House of Representatives Ways and Means Task Force on Foreign Source Income.

5. That the Executive Secretary request permission to attend any public meetings regarding the pending treaty and the task force proposal or similar proposals which may be considered by the House Ways and Means Committee, Senate Finance Committee, or the Senate Foreign Relations Committee, and urge that the parts of the treaty relating to state taxes be reserved, and that any task force or Senate Finance Committee proposal to limit state taxes or state taxing methods be rejected.

NATIONAL CONFERENCE OF STATE LEGISLATURES,
Washington, D.C., September 9, 1977.

HON. JOHN J. SPARKMAN,
Chairman, Senate Foreign Relations Committee,
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR SPARKMAN: As President of the National Conference of State Legislatures, I am writing to inform you of our recently adopted position on the United States-United Kingdom tax treaty. The National Conference of State Legislatures is the non-partisan organization representing the nation's 7,600 state legislators and staff.

We would like to encourage you and the Foreign Relations Committee to place reservations on those sections of this treaty which would infringe upon the separate tax systems of the states. With a majority of the states utilizing the unitary tax method to some degree, our Conference unanimously adopted this position calling on the U.S. Senate to delete these restrictions from the treaty. I think it is important to point out that many states are concerned with this issue as evidenced by the support for our position by elected state legislators from all parts of the country.

We do not feel that this treaty should forbid the use of the unitary taxation method by the states. This unprecedented action by the treaty negotiators to intrude into the constitutionally separate tax systems of the states is the basic issue. We do not feel that the proper method of modifying state tax laws should be through the adoption of a treaty by the federal government. The state legislators who are responsible for writing state tax laws are willing to engage in a full examination of the tax laws of both the state and federal governments in order to develop improvements to the methods of taxation of multi-national corporations.

Although the arms-length method of taxation has been proposed by some as the only method states could use to tax multinational corporations, the experience in many states which use this method have pointed out some major problems. Those states which utilize the arms-length approach have not had the necessary cooperation from the Treasury Department to make this an effective approach. Careful study by state legislators, governors, and state tax administrators of taxation methods must take place before we should even consider such a radical step to simply outlaw the unitary tax method.

I thank you in advance for your careful consideration of an issue which raises fundamental constitutional questions. If you or your staff should have any questions, please contact Jeffrey Esser in our Washington Office of State-Federal Relations.

Sincerely,
FRED E. ANDERSON,
President, National Conference of State Legislatures.

NATIONAL CONFERENCE OF STATE LEGISLATURES
POLICY POSITION

UNITED STATES-UNITED KINGDOM TAX TREATY

The National Conference of State Legislatures urges Congress to delete provisions from the United States-United Kingdom Tax Treaty which will infringe upon the separate tax systems of the states and other governmental units. In adopting this treaty, the

U.S. Senate should place reservations on the tax treaty articles that forbid the states from utilizing the "unitary taxation system."

Adopted at the Annual Meeting of NCSL, August 5, 1977, Detroit, Michigan.

RESOLUTION: UNITED STATES-UNITED KINGDOM TREATY AS ADOPTED BY THE EXECUTIVE COMMITTEE OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL EXECUTIVE COMMITTEE MEETING

Whereas, the United States Senate will consider a tax treaty with the United Kingdom which would preempt state taxing power and methods; and

Whereas, adoption of such a treaty would substantially reduce actual and potential tax revenues to the benefit of multinational corporations;

Therefore, be it resolved that:

1. the Executive Committee of this Association opposes provisions in this treaty which represent an unwarranted intrusion of the federal government in tax matters of state concern; and

2. the Executive Committee of the National Association of Attorneys General urges Congress to delete provisions from the United States-United Kingdom Tax Treaty which restrict state taxing methods; and

3. the Washington Counsel of the National Association of Attorneys General is authorized to communicate the position of the Executive Committee to the appropriate members of Congress and the Administration.

FEDERAL INTERFERENCE WITH STATE TAXING POWER

A. ISSUE

Deletion of paragraph 4 of Article IX of the United States-United Kingdom Tax Treaty, regarding the Western states' rights to use the unitary tax method of apportioning taxable income.

B. GOVERNORS' POLICY STATEMENT

The United States Senate Foreign Relations Committee is requested to recommend to the full U.S. Senate that the United States-United Kingdom Tax Treaty not be ratified so long as paragraph 4 of Article IX remains a part of the treaty and restricts the states' power to use the unitary tax concept.

The Governors also feel that such federal interference with state taxing powers is not warranted and contrary to the sovereign interests of all states.

C. FOLLOW-UP ACTION REQUESTED

1. Transmit resolution to the United States Senate Foreign Relations Committee.

2. Transmit the resolution to the Secretary of Treasury.

3. Transmit resolution to the Western Congressional Delegation.

D. BACKGROUND

A tax treaty was negotiated between the United States and the United Kingdom that restricted in paragraph 4 of Article IX, the powers of the states to use the unitary tax method. The restriction on the unitary method prevents the states from using the worldwide combination method of allocating income between states. Three states (California, Oregon and Alaska) currently use the worldwide combination of unitary income method and it is estimated that the passage of the treaty as it presently stands would cost these states an estimated $150 million a year. Several other Western states are contemplating adopting the new concept of tax allocation.

The Federal government attempt to restrict state taxing powers comes at a time when the Western states are making great strides in adopting common practices and uniform regulations in the administration of interstate taxation through the Multi-State Tax Commission.

The ACTING PRESIDENT pro tempore. The Senator from New York.

Mr. JAVITS. Mr. President, I yield myself 5 minutes.

If Senator STEVENS will give me his attention, Mr. President, I happen to be a fan of Alaska. I think I have done many things. I hope, in my lifetime and here in the Senate I may do many more to aid our outpost State in order to develop its fantastic potential.

I would not for a moment try to over-ween the Senator by countering his arguments in some confrontational way. But I would like to point out a number of things which could be helpful. That is the reason I express them.

First, Alaska is an enormous area that needs enormous investment. Not that I am trying to convince the Senator, but I simply wish to commend to the Senator, who is probably the most patriotic advocate one could find of his State, the experience and study made by both the Governor of California and the Governor of West Virginia. I think before the Senator was in the Chamber this morning I read Mr. Rockefeller's letter respecting West Virginia, and it was very instructive as to what he said. West Virginia started out against it and ended up for this treaty.

I would like to reread, if I may, that paragraph. It has gone into the RECORD:

We estimate that the treaty prohibition on the use of the unitary tax system would reduce corporate tax revenues by approximately $300,000 annually. However, in reviewing the aggregate impact of the treaty, I am now confident that the tax gains to West Virginia by reason of the treaty should more than offset this loss.

Comparable experience is interestingly reported by Governor Brown of California. [p. 18657] Again, I would like to refer to the telegram which Governor Brown sent, joined in by Senator

CRANSTON. This morning Senator HAYAKAWA spoke to exactly the same point. The telegram said:

Furthermore, it is the judgment of California's Business and Transportation Secretary, Richard Silberman, and the State Director of Finance, Roy Bell, that ratification of the treaty will have a positive net economic impact on California.

I would like to give the Senator an example of this point.

The Hong Kong and Shanghai Banking Corporation had an interest in a California branch. One of the horror stories about the applications of the unitary tax system by California was to this Hong Kong and Shanghai Banking Corporation holding. Apparently, the State of California taxes them more than their capital because of the unitary system. I understand that now that they have acquired an important interest, perhaps as much as a controlling interest, in the Marine Midland Bank, they are more than happy to sell their interest in their California holding.

Now, in addition, this treaty, as the Senator knows, is heavily supported by business interests which do very broadscale investing.

Finally, the Senator is right about the fact that the United States expects that the countries of the European economic community, will be adopting the same tax integration system that the United Kingdom has already adopted and hence that we can expect that there will be an extension of this principle in other treaties, undoubtedly, with France, the German Federal Republic, and possibly Canada.

Finally and very importantly, the Treasury, and I now make this part of the record and legislative history.

The Treasury has sought to put to rest the fear that article 9(4) is merely a first step toward greater Federal restrictions on State taxing authority, particularly that a provision like article 9(4) will be included in other treaties and that future treaties will go beyond the limited scope of article 9(4) to impose greater restrictions on State taxation.

With regard to the second point, Treasury has no intention of limiting State taxation in future treaties, beyond the type of restrictions provided in article 9(4):

Now, the second point is that future treaties will go beyond the limitations of 9(4). So they negate that.

With respect to the first point, that a provision like 9(4) will be included in other treaties. Treasury has taken the position in discussions with other countries that a provision like article 9(4) cannot be considered until the Senate has acted on the United Kingdom Treaty.

If the treaty is approved, Treasury will consider the inclusion of similar provisions in other treaties, but only in return for commensurate concessions on the other side.

The Treasury does not want to expand the concept beyond these limitations, and I think that is an important commitment to a State like Alaska.

If the reservation is rejected, which I hope is done — and I shall do my utmost to bring it about — I hope the State of Alaska, one, will hold the Treasury to this promise — and I will help the State of Alaska, and I think the Senate will; and, two, that the State will do its utmost to take advantage of a new climate for investment to attract rather than repel foreign investment.

Mr. STEVENS. Mr. President, will the Senator yield me additional time?

Mr. JAVITS. How much time does the Senator want?

Mr. JAVITS. I yield.

Mr. STEVENS. Mr. President, I am indebted to the Senator from New York for that statement, and I believe the record is improved by that statement being in the RECORD.

I say to the Senator from New York that the problem is not solely with this treaty. The problem is that the prospect he mentions, that this concept of using the treaty power to limit the

exercise of the rights of sovereign states, will be extended to Canada, to Germany, to Japan, to our trading partners.

We have the strange situation that in my State, we will not affect domestic international corporations, multinational corporations, and their activities. They still will be subject to the unitary method of apportionment. It is only those corporations that originate and have their home offices, so to speak, in the United Kingdom that will get this umbrella of protection from State taxation. That discrimination, in my opinion, violates the equal protection concept of our Constitution.

I do not understand why the treaty power should be used by the executive branch in a manner that Congress could not legislate. We, as Congress, could not tell the sovereign states that they could not tax the United Kingdom corporations in this manner but that they could continue to tax those which originate in every other nation of the world.

The net result of the treaty power is to bring about a unique form of tax discrimination. As the Boston Globe points out, it is really taxing State taxation through the use of the treaty power.

I hope the Members of the Senate are not misled by the action taken by our colleagues from California and the Governor of California.

I have a letter from the comptroller of the State of California, dated June 9, in which he states:

> Many questions have been raised concerning the contradictory positions taken by the California Franchise Tax Board and Governor Brown as to the Treaty. The Franchise Tax Board is by statute an independent department governed by a three-member board. I, as the Chairman, am also the elected Controller of the State of California.
>
> Another member of the Board is the Chairman of the State Board of Equalization who is also elected by the people of California. The third member is the Director of Finance who is appointed by the Governor.

The Franchise Tax Board is charged with the effective and equitable administration of the California Corporate Franchise and Income Tax Law and the Personal Income Tax Law. The Board's opposition to the treaty is based upon its duty to insure that these taxes are effectively and equitably administered as to all taxpayers.

Our decision in respect to Article 9(4) is based solely on our desire to preserve the integrity of the tax systems of California and other states and to insure that no organization, either foreign or domestic, has an advantage over another due to the structure of the tax system. Passage of the treaty without a reservation as to Article 9(4) would, of course, place U.K. based corporations in a preferred position.

On July 19-20, 1977, I opposed the treaty when it was heard by the Senate Foreign Relations Committee. The California Franchise Tax Board has consistently opposed the treaty—its opposition has never waivered. The enclosure summarizes the department's view as to why state taxes should not be secretly dealt away by the Treasury Department. I or other members of my staff would be happy to discuss with you the reasons why the treaty should not be approved unless Article 9(4) is reserved.

Mr. President. I ask unanimous consent to have printed in the RECORD at the conclusion of my remarks, the letter to which I have referred, together with attachments.

* * *

[p. 18658] Mr. STEVENS. This RECORD should contain our own Budget Office estimate of the cost of the treaty provisions.

The ACTING PRESIDENT pro tempore. The time of the Senator has expired.

Mr. JAVITS. I yield the Senator an additional 5 minutes.

Mr. STEVENS. The Budget Office of Congress indicates that the 1978 revenue loss, not counting those related to ACT and the PRT, is $100 million.

It goes on this analysis to show that in 1983, there will be a loss of $45 million. That is a revenue loss to the United States. It does

not deal with the revenue loss to the individual States. That is what worries me.

What are we going to do? Are we going to find that the United Kingdom now is going to be a haven for corporations that deal with Western States that have the unitary method? Is it going to become the Delaware of the world, where corporations are going to organize so that they can have the impact of this tax haven that the executive branch secretly negotiated away, in violation of the Constitution?

I think the Senate should wake up. This is the first use, to my knowledge, of the treaty power to invade the taxation rights of the sovereign states. It is a foot in the door. The result is going to be — and I hope the Senator from New York is listening — that my State is going to change its taxation methods.

In addition, I hope my State will challenge the constitutionality of this treaty, because I do not think the executive branch should be able to evade the equal protection rights of every corporation that will be discriminated against because of this treaty.

The domestic multinational corporations, the domestic national corporations, and corporations doing business solely in my State will have to bear an increased amount of the burden of taxation because those originating in the U.K. get preferred treatment. It will become literally an island of preference due to the United States-United Kingdom Tax Treaty.

I believe that is wrong. Particularly, I abhor the thought that it is going to happen with respect to corporations coming from our neighbor to the south. It is your neighbor to the north; it is our neighbor to the south. The effect of this will be that corporations coming into my State from Canada will have immunity. They will not face the same kind of apportionment of their worldwide income. They will have advantage over the corporations that come from the State of Washington, for example. Those are foreign corporations to us, in terms of our State law. They are not corporations that originate in Alaska.

This treaty says that foreign multinational corporations coming in from the British Isles cannot be taxed the same way as

corporations are that come from the State of Washington. If the Government follows the procedure that I believe the Senator from New York anticipated — and as I anticipate — that we will extend this kind of haven to corporations originating in Canada, it will mean that the Canadian corporations can come up and to business and bid, and we cannot exclude them. They will come up and do business and outbid the corporations that come from the South 48, to be involved in building such things as Alaska pipelines, drilling for oil and gas, developing our minerals. Then we will give the same haven to those that originate in Japan.

The Senator says we need to attract capital. We need to generate capital within our own country. We have had no problem getting foreign capital to come into my State. The Japanese have been turned down two or three times recently in their bid to buy almost all the hotels in the State. As I pointed out yesterday, they own, as the Senator from Washington knows, more than 50 percent of the shore-based fishing facilities in my State, and the foreign ventures are trying to come in and ruin the impact of our 200-mile limit bill.

EXHIBIT 2

CONTROLLER OF THE
STATE OF CALIFORNIA,
Sacramento, Calif., June 9, 1978.

Hon. TED STEVENS,
Senate Office Building,
Washington, D.C.

DEAR SENATOR STEVENS: Enclosed is a copy of the California Franchise Tax Board's response to the paper furnished you by the Department of Commerce.

Many questions have been raised concerning the contradictory positions taken by the California Franchise Tax Board and Governor Brown as to the Treaty. The Franchise Tax Board is by statute an independent department governed by a three member board. I, as the Chairman, am also the elected Controller of the State of California.

Another member of the Board is Chairman of the State Board of Equalization who is also elected by the people of California. The third member is the Director of Finance who is appointed by the Governor.

The Franchise Tax Board is charged with the effective and equitable administration of the California Corporate Franchise and Income Tax Law and the Personal Income Tax Law. The Board's opposition to the treaty is based upon its duty to insure that these taxes are effectively and equitably administered as to all taxpayers.

Our decision in respect to Article 9(4) is based solely on our desire to preserve the integrity of the tax systems of California and other states and to insure that no organization, either foreign or domestic, has an advantage over another due to the structure of the tax system. Passage of the treaty without a reservation as to Article 9(4) would, of course, place U.K. based corporations in a preferred position.

On July 19-20, 1977, I opposed the treaty when it was heard by the Senate Foreign Relations Committee. The California Franchise Tax Board has consistently opposed the treaty — its opposition has never waivered. The enclosure summarizes the department's views as to why state taxes should not be secretly dealt away by the Treasury Department. I or other members of my staff would be happy to discuss with you the reasons why the treaty should not be approved unless Article 9(4) is reserved.

Sincerely,
KENNETH CORY.

CALIFORNIA FRANCHISE TAX BOARD REBUTTAL OF U.S. DEPARTMENT OF COMMERCE PAPER ON THE U.S. INCOME TAX TREATY WITH THE UNITED KINGDOM

This is a rebuttal to the Department of Commerce April 1978 paper about the supposed benefits of the pending U.S.-U.K. Tax Treaty. That paper contains numerous misstatements of fact and shows an almost complete lack of understanding of the unitary method of computing the income subject to taxation.

The U.S.-U.K. Tax Treaty is the *first* in the nation's history which directly limits the states' most fundamental attribute of sovereignty, i.e., taxing powers. The secretly negotiated treaty has been vigorously supported by the multinational corporations, the Treasury, and, now, the Department of Commerce.

It is difficult to perceive why a very modest state tax on net income would be of such concern to the U.S. Government, unless it fears its archaic method for determining income of multinational corporations will come under Congressional scrutiny, and multinational corporations, like other taxpayers, will be called upon to pay their fair share of taxes. It is even more difficult to understand the apparent great concern shown by the supporters of this treaty for foreign multinational corporations since in practically all cases foreign countries either exempt from taxation the income of their multinational corporations earned outside of their own country or, if income is taxed, a credit is allowed for all foreign taxes paid, both state and national. Thus, when a state is prohibited from determining income of a multinational corporation in a realistic manner one of two things occurs: Either the income is exempt from all income taxes or the country of domicile of foreign corporations receives a subsidy since it will not be required to allow a tax credit.

If the Department of Commerce were truly interested in protecting American businesses it would evaluate the tax privileges multinational corporations now enjoy and determine if they are receiving tax breaks which are not available to local, and to a lesser extent, interstate businesses.

To date, no one, including Congress, has obtained an evaluation of the merits of the separate accounting-unitary concepts from the Internal Revenue Service's auditors who conduct international audits. Although the paper suggests that the unitary concept can result in overtaxation, the plain truth is that overtaxation does not occur. If Congress has any doubt, state and local tax returns of multinational corporations could be subpoenaed and evaluations made as to the amount of income which is in fact reported to the taxing authorities. In fact, Congressman Vanik's yearly analyses of the effective tax rate on multinational corporations show clearly

the multinationals are not paying their fair share of the tax burden.

Any fair discussion of the unitary-separate accounting concepts should include an evaluation of the two methods, including the opportunity under each method for the diversion of income to tax havens, the concealment of income by use of accounting gimmicks, and the ability to affect income merely by changing corporate form. (These subjects are discussed in the Position Paper California filed with the Senate Foreign Relations Committee at its hearing on the treaty on July 19 and 20, 1977. (See Attachment 1, pages 1-9, and Attachment 2, pages 1-12.)

[p. 18659] The "evaluation" in the Commerce study is neither objective nor accurate. It is obvious that those preparing the "evaluation" lacked a substantive understanding of the unitary concept. The nine points made in opposition to the unitary method will now be considered.

1. The Treaty is a "package" that confers on U.S. taxpayers and the 50 states significant benefits which are costly to the United Kingdom. Failure to ratify the treaty complete with those provisions which are beneficial to the U.K. multinationals would place the whole treaty in jeopardy.

Page i of the Summary clearly establishes that most of the benefit for the rebate of the Advanced Corporation Tax (ACT) is for the benefit of United States-based corporations. (1975-78 $245 million and $60 million thereafter. For individuals the rebate for 1973-78 is $136 million with $25 million thereafter.)

The States and California in particular would not benefit from the refund provided for the ACT tax. Most corporations are domiciled in states which do not tax dividend income. Therefore large amounts of such income are currently exempt from tax and the credit given these corporations under the treaty will generate no additional tax for the States. Furthermore when the income of related corporations is included in a combined report and taxed under the unitary method as is the case with California, dividend income is excluded from the tax base. It is the operating results of all the entities which is taxed, not the dividend income which flows between them. Therefore, the additional state tax imposed

on corporations as a result of the rebate of ACT will be minimal. In California's case the only corporations which will pay a greater tax as a result of this credit are those which are domiciled in California and which have United Kingdom subsidiaries which are conducting a business which is unrelated to the general business carried on by the corporation.

As for individuals, there is no information as to where they are located nor is there any information as to the amount of foreign dividend income reported by U.S. investors. Accordingly, the additional state revenue attributable to individuals is at best speculative, and, in any case, of no great significance.

The petroleum revenue tax which the treaty makes creditable will have no impact on the States but will be utilized solely as a reduction of federal income tax.

2. State application of unitary apportionment to the business enterprises of foreign countries is a disruptive factor in the foreign relations of the U.S. Government.

The premise is not acceptable. States, in applying their tax laws to private, profit-making corporations, are not interfering with foreign relations. It is true that since the owners of such companies are near governments in themselves they can immediately bring their concerns to their governments. Undoubtedly many foreign corporations are dismayed when they find their income is determined by a specified formula, and under circumstances where there is no opportunity for back-door dealing. What is involved surely is not a matter of significant foreign policy, it is only the application of a time-tested and judicially approved concept for determining income. What is detested is the simple fact that the unitary concept exposes income to tax in a fair and equitable manner.

The assertion that the states have refused to make any accommodations when foreign governments' complaints have been transmitted is simply not true. The only time a problem with respect to foreign corporations was called to California's attention was in 1968. The problem involved detrimental foreign taxes imposed upon certain U.S. air and shipping corporations because of California's imposition of a tax on the foreign lines. As a result

California added Section 24320 to the California Revenue and Taxation Code, which exempts on a reciprocal basis the income of foreign sea and air carriers.

In the California Franchise Tax Board's view, there is a considerable difference between a problem and protectionism. The Board is willing to approach any problem with an open mind. It, however, applies its laws in an even-handed manner, and does not back off in the application of its laws merely because some multinational corporations are unhappy with the result.

The commentators tipped their hand as to why they want to destroy the unitary concept on page 16 of the report which stated:

The structure of international tax relations developed between the U.S. Government and the governments of foreign countries has made no provision for this situation, which is new and threatens to spread unless steps are taken to bring State practice into line with standard international tax practice.

Undoubtedly, the unitary concept, which has been used for over fifty years, will spread because it is workable and prevents tax evasion by manipulation of corporate forms. Its use would be greatly accelerated if the U.S. Government would adopt the Treasury Department's staff recommendation of its adoption for federal taxation.

The last paragraph of point two overlooks history. Unlike most governments, our federal government is one which had its powers delegated to it. It does little if any violence in the case of most foreign countries when national governments deal with all taxes. The same cannot be said for the United States because unless the states retain their taxing powers their sovereignty is irrevocably subordinated to whoever for the moment is negotiating treaties for the federal government.

3. The U.S. Government should not engage in or permit a tax practice that if adopted by other countries would be harmful to the U.S. economy. The adoption abroad of the unitary apportionment system of taxing income could be very harmful to the U.S. economy.

It is absurd to conclude that subjecting U.S. corporations abroad to the same taxing systems used by most of the states would cause any significant compliance problems. In reality compliance would be far easier than is now the case if foreign countries could or would subject intercompany transactions to an arm's-length audit. The facts are that foreign countries and the Internal Revenue Service give only lip service to an arm's-length adjustment, and in the very few occasions when an adjustment is proposed, a skilled attorney has no great difficulty in negotiating a favorable settlement.

We are not aware of any leaks of trade secrets by state taxing authorities. The reason is that trade secrets are not required for tax purposes. What is required is financial information of the kind included in reports required by the Securities and Exchange Commission.

The Treasury Department itself has recognized that accounting and translation problems discussed are grossly overstated.

In its justification to support the President's 1978 Tax Program to eliminate the deferral of foreign source income, treasury said, on page 291:

Administrative problems that have been surmountable in these cases will likewise be surmountable when deferral is terminated.

The Commerce paper advances the proposition that use of the unitary method by other countries would prove harmful to U.S. multinationals. This argument perhaps is true with respect to removing the use of tax haven jurisdictions because under a formula method which reflects the activities of a business which actually give rise to income, little or no income would be allocated to paper corporations domiciled in these tax havens. Furthermore, the Commerce Department has completely ignored many of the arguments which are currently advanced against the use of the unitary method by the states. These arguments take the position that the formula results in the over-allocation of income to the states rather than an under-allocation. As long as similar formulas and similar methods are used it is hard to see how this formula which results in an over-allocation of income to the states could also result in an over-allocation of income to foreign countries.

4. Cases of truly unitary operation of related business entities which often make unitary apportionment of multistate business income more practical than a separate accounting of income earned within the State occur much less frequently in the context of multinational business headquartered abroad.

This discussion is a defense of the indefensible. Essentially it is an argument that if we trust the multinationals, their corporate form, and their self-serving accounting records, they will pay the correct amount of tax. California's experience hardly bears out these conclusions. The ease with which corporate accounting records can be manipulated is demonstrated in the Position Paper California filed in connection with the hearings on the treaty. (See Attachment 3, pages 1-26.)

Some of the more recent cases in California currently in litigation involving additional assessments as the result of unitary apportionment and the amounts involved are:

	Million
United States Steel Corporation, filed 5-13-77	$4.3
Mobil Oil Corporation, filed 6-3-77	12.6
Gulf Oil Corporation, filed 4-6-78	26.4
Alcan Aluminum, filed 4-15-78	1.7

We agree that U.S. state boundaries are irrelevant in the operation of a unitary business. They are equally irrelevant in the case of a multinational corporation regardless of where it is headquartered. All one has to do is go shopping or read the advertisements in any newspaper or magazine to realize that there is truly a worldwide market. For example, who knows where the crude oil was produced that is delivered at the local pumps, or where the various components of any manufactured product were produced? Despite the assertion that a subsidiary paper shield makes an activity separate, such conclusion is merely exalting form over substance.

Although the income assigned by separate accounting records may differ from that determined by an apportionment formula, are the corporate managers or shareholders concerned about which of their various activities is more profitable? Or is their real concern whether the operations in total produce income? An

obvious example of a cost operation which may be vital to the long-range success of a business is research.

Should this activity be isolated or shown as a loss operation even though it develops products which enable a business to grow and prosper?

The Commerce Department paper also fails to realize that the unitary method is a two-way street. In some circumstances the jurisdiction applying the method will increase its revenue, but in other circumstances there will be an actual decrease in the amount of tax assessed by the state. There have been several court cases which demonstrate that this does in fact occur. In California in 1962 two cases were decided, Honolulu Oil Corporation v. Franchise Tax Board, 60 Cal. 2d 417, 386 Pac.2d 40 (1963) and Superior Corporation v. Franchise Tax Board 60 Cal.2d. [p. 18660] 406, 388 Pac2d 33 (1963) which sustained the use of the unitary method when requested by the corporations resulted in a substantial reduction of tax. Recently there has been a decision in Ohio where the Commissioner was required to use the unitary method to compute the income of a corporation doing business within that state. This case involved Beau Brummell Ties, Inc. v. Lindley Ohio Board of Tax Appeals, No. E-1898, March 14, 1978.

The discussion as to invalid apportionment formulas is irrelevant. What is under consideration is not an arbitrary apportionment formula, but one which has been tested by time and repeatedly approved by the United States Supreme Court.

The "arm's-length" method which is so vigorously defended is not workable. In fact, the Internal Revenue Service itself in most cases, according to a noted commentator, uses the unitary concept.

To further demonstrate the unreliability of separate accounting, in January of 1977 Professor Jerome Zeifman, Chief of Staff and General Counsel to the House Judiciary Committee 1973-74, and general counsel to several House subcommittees for fifteen years prior thereto, made a study for the State of Alaska.

In part (p. 24) Professor Zeifman found:

> The use by large, vertically-integrated petroleum companies of separate accounting techniques for tax avoidance purposes in Alaska was demonstrated above by Table VIII. In general, this table shows that during 1973, 1974, and 1975, when seven of the largest oil companies operating in Alaska used separate accounting to determine their Alaska taxable income, in no case was any income assigned to Alaska. Instead, each separate accounting was asserted (by the taxpayer) to have demonstrated that the Alaskan operations were being conducted at a loss.

The finding that oil companies are reporting on a separate accounting basis is ridiculous when they themselves describe their business as unitary. See page 1817 of Hearings before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary United States Senate Re S. 2387 and Related Bills. In connection with a request for the clarification of financial data, Exxon Corporation said, in part:

> As we indicated in our December 16 response and in response to other committees, the FTC's Line of Business and Corporate Patterns reports, and to the FASB's proposal for segment reporting, the petroleum business is unitary in nature.

Finally the Commerce Department study takes the position that the states are applying the unitary method to corporations which are not unitary. Clearly if a foreign corporation or any corporation can demonstrate that its activities do not constitute a single unitary business, that is, that the activities are not interrelated, dependent upon or contribute to each other, than the state tax authorities will not be able to apply the unitary concept. If in fact foreign multinational corporations are less unitary than their United States counterparts, the state tax officials would not be able to apply the unitary concept to them.

5. The unitary apportionment system is difficult to administer and an inaccurate method of apportioning the income of multinational business among taxing jurisdictions.

This discussion demonstrates a lack of understanding of both separate accounting and the unitary concept. Undoubtedly the

cost of a few fungible goods can be determined by separate accounting. However, how is an arm's-length determination made with a patented product, a product based on a trade secret, or any complex finished product? To cite only a few examples: What is the fair market price for a soft drink? a new drug? or an automobile? These, obviously, are only a few of the items that tax administrators must deal with.

The second paragraph beginning on page 24 mentions reasons why the writer thinks a unitary determination is not workable. A cursory reading clearly demonstrates that in activities as described an arms-length determination is impossible. Finally, if the unitary concept is difficult to administer, why the oft-expressed concern that its use may spread?

Turning to the further points.

(A) The Unitary Group:

First, the information required for a unitary computation is far less than would be required if a meaningful arm's-length analysis is made. Next, it is financial information, most of which is in the public realm, which is required, not business secrets.

The fact that some companies have prevailed upon their countries of domicile like Great Britain to pass laws restricting their furnishing financial data should never be accepted as an excuse for allowing a private profit-making corporation from ignoring a state's tax laws. After all, businesses are aware of the state's requirements when they enter.

(B) World Income of the Unitary Group:

It has never been demonstrated that foreign corporations do not have the ability to determine their worldwide income. In many cases their accountants and tax managers have been trained in United States universities, and, of necessity, they follow United States accounting methods for their internal control purposes.

The report seems to assume that the various segments of a unitary business operate in a vacuum. Are we to actually believe that the parent company executives responsible for the worldwide operations of a multinational corporation are not aware of what is

going on in their several branches, divisions, and subsidiaries? Are we to further believe that the results of operations are not continuously and instantly available, and in a form which, if made available, would permit the preparation of a combined report?

The exact opposite, of course, is true.

There was a discussion of arbitrary tax assessments. Such are used sparingly, and even then in most cases they are based on published financial information. Also if a business chooses to cooperate, invariably its income and factors can be determined quickly and at minimum expense. If they choose not to cooperate, a provisional assessment is the only alternative.

(C) Apportionment of Taxable Income to the State:

The only substantive complaint about a three-factor formula is that in many cases the income apportioned differs from the income assigned by self-serving accounting records. In many cases, as demonstrated above, the tax change is immense.

Subpoints (1) to (4) attempt to demonstrate the errors of an apportionment formula.

Subpoint (1) suggests that if production takes place in one country and sales in another, there may be a mismatching of income because the profit relationship may vary. This conclusion misses the basic reason for formulary apportionment. As the California District Court of Appeals noted in *Chase Brass & Copper Co.* v. *Franchise Tax Board,* 70 C.A. 457 at 473 (1977):

Generally, Chase's contentions overlook the fact that a unitary business is one in which all parts contribute to the total profits in unmeasurable amounts. Thus, if the profits of any portion of the unitary business are separated from the rest, the base is necessarily inaccurate as the profits from any segment cannot be determined with certainty. (Emphasis added.)

Subpoint (2) suggests wage rates may cause distortion. The United States no longer pays the highest wages. Furthermore, the unitary concept reflects business reality. Under the unitary concept the factors reflect the owner's judgment that manufacturing facilities are located and the wages paid are those which, from a

business standpoint, are the most profitable to it. Also, when fringe benefits of the kind which would constitute taxable income under U.S. concepts are included in the payroll factor, California has yet to find a case where substantial distortion has been documented.

Subpoint (3) suggests that distortion may occur because profit margins differ. This may occur, but it overlooks the fact that if a business activity is unitary, taxing jurisdictions share in the fate of the total unitary business regardless of profit margins as reflected by separate accounting records.

Subpoint (4) repeats the old story of administrative difficulties, but as Treasury itself noted in justifying a portion of the President's tax reform proposals of 1978, these administrative problems are far from insurmountable.

The Commerce Department study suggests that the three-factor formula will reach an unreasonable and unfair result. This is not the case. The courts have recognized for years the fairness of the three-factor formula. Those cases in which they have found a formula to be unfair have usually involved the application of a single formula. Also it should be noted that under the Uniform Division of Income for Tax Purposes Act the state tax commissioner is empowered to exercise his discretion to delete factors from the formula, add additional factors to the formula or to use any other means which is appropriate to fairly reflect a taxpayer's business activities, within the state. Given the discretionary power which state tax commissioners hold under the Uniform Act, a question of unfairness, if it existed under the three-factor formula, would certainly be subject to judicial review.

6. Use of the unitary apportionment method may result in the State taxing income of the multinational enterprise that is not derived from or substantially related to the operations of the enterprise in the taxing State.

The opening paragraph overstates the problem because the unitary income includes only income of a commonly owned business when the operation of a portion of the business done without a state is dependent upon or contributes to the operation

of the business without the state. Thus, common ownership alone is not a basis for unitary apportionment.

The next paragraph simply rejects the realities of a unitary business. It accurately describes certain unitary activities and indicates why there should be no geographical limitations with respect to unitary activities.

In noting the limited application of the treaty, it should be noted that the treaty permits apportionment when branch activities are operated in the U.S. What this means is that if the U.K. parent's operations are unprofitable, business will be conducted through branch operations. If the U.S. operations are unprofitable, business will be conducted through a subsidiary. Therefore, the treaty provides the U.K. corporations with the ability to control their income subject to state tax by the corporate form by which they conduct their activities.

It should also be noted that the authors do not mention that the treaty limitation runs only against U.S. taxing authorities. It is possible that under the language used in the treaty that a U.K. multinational can utilize the unitary concept if it wishes to do so.

It should also be realized that the multinational business may often operate at a loss in a particular jurisdiction in order to obtain a competitive advantage over local businesses. By that means the large multinational corporation can use its income in [p. 18661] our jurisdiction to drive out its competitors in another jurisdiction and in this way discriminate against small business operations. Certainly the charges which have been brought against the Japanese steel companies and television manufacturers involving dumping in the United States' market demonstrate that this is a real threat. While the operations within a particular jurisdiction may actually create a loss, these operations can contribute to the maximum efficient usage of plant and capacity in another jurisdiction which thereby gives rise to the largest overall profit which the business can realize. Only the unitary method deals with these problems in a realistic manner.

As for the unsolicited concern for the States, it is suggested that their business climate and tax policy is a matter of their concern. In fact, there is no empirical evidence which demon-

strates that the business climate of any individual State has been significantly affected by the use of the unitary method of taxation. California, which is perhaps the primary proponent of the unitary method, has consistently ranked as one of the most attractive jurisdictions for foreign businesses.

Furthermore, the unitary system does not, as suggested, tax out-of-State income. It is only a more accurate method for determining income from local sources. If the States were taxing income over which they did not have nexus, such action would be quickly stopped by application of Constitutional principles. Such is not the case: and that is why the multinational corporations are seeking to sneak in through the back door by way of a treaty.

7. Prohibiting States from using the unitary method to tax multinational businesses need not cause the States to lose revenue to which they are legitimately entitled.

The dividend income has been previously discussed. Its impact is minimal. The revenue which is at risk for California (about 10 percent of its corporate base, $125 million as of 1974) is real. The risk is far greater because the treaty will be used as a lever to upset the whole unitary concept. If this occurs, the collective loss to the States will be staggering. As to Section 482, if it cannot be adequately enforced with the Internal Revenue Service with its large and competent staff, is it realistic to assume States with their meager resources and staffs will enjoy any success? The Joint Committee on Internal Revenue Taxation concluded that they would not.

8. The argument that using a tax treaty to address the unitary apportionment problem bypasses the House of Representatives and is an unfair "end run" taken without notice to the States is not supported by the facts.

What this argument overlooks is that the Executive Branch dealt away state taxing powers. It did so without consulting the states, and even without a full awareness of the impact of such action.

The article suggests that the British negotiators have no legal access to Congress. This ignores reality. The tax considerations of

Article 9, Section 4, do not even arise unless there is British corporate activity in the U.S. It is absurd to suggest that persons engaged in business in this country cannot communicate with Congress.

And certainly no such restriction was apparent during the July 20, 1977 Senate Foreign Relations Committee hearing on the treaty when the statement of Mr. John S. Nolan, speaking on behalf of the British National Committee of the International Chamber of Commerce and the Confederation of British Industry, was received by the Committee.

The article also suggests that states are entitled to no more consideration than private interests, even when their powers and revenue are given away. As for the 1973 Senate Hearings, in which California participated, there was no indication whatsoever that California's application of the unitary concept caused concern to the Senators who attended the hearings.

9. Placing limits on State use of unitary apportionment for foreign based enterprises by means of a tax treaty benefits the United States more than achieving this result by Congressional passage of a generally applicable law to the same effect.

The difficulty of a quid pro quo is that the consideration should flow from the principals. The states undoubtedly could negotiate very favorable unitary treaties if they could trade off Federal taxes. It is, of course, an easy bargain when one is trading off rights of another which is not a party to the negotiations.

The principal benefit which results from dealing with the unitary method in a treaty is that it will permanently engraft into the law of the United States a protection for foreign multinational corporations and will make it that much easier for domestic multinationals to obtain the same benefits for themselves under the guise that they are being discriminated against. Clearly this must be the intention of the U.S.-based multinationals or why would they otherwise support a provision in a tax treaty which can only place them at a competitive disadvantage to their foreign counterparts.

Mr. MAGNUSON. Mr. President, will the Senator yield?

Mr. STEVENS. I yield.

Mr. MAGNUSON. This would apply disastrously to our fishing and to our attempt to keep fisheries for American fishermen. They are starting to come in now, and the Senator from Alaska and I have had a difficult time trying to keep them out, have we not?

Mr. STEVENS. We certainly have, I say to the Senator from Washington.

Mr. MAGNUSON. To the jeopardy of American corporations.

Mr. STEVENS. The net result will be that any corporation that comes from the British Isles, from the United Kingdom, and owns vessels that are beyond the 3-mile limit or worse, are within the 3-mile limit, will have a preference over vessels from my State or the Senator's State, and the net effect of it is to bring the foreign vessels closer to our shores.

I do not understand why we cannot have the right to tax as we choose. The courts have held that the unitary method is a fair way to apportion income of multinational corporations.

The PRESIDING OFFICER (Mr. PAUL G. HATFIELD). The Senator's time has expired.

Who yields time?

Mr. JAVITS. I yield 2 additional minutes to the Senator.

Mr. STEVENS. I thank the Senator very much.

I shall end my comments now, and I hope to have comments later.

I will ask the Members of the Senate to look at the record. The record shows that our own Congressional Budget Office shows the loss to the Federal Government of the adoption of this treaty.

The record shows that the national organizations that are involved with tax policy, both those of a public interest nature and those that deal with State legislatures themselves, the attorneys general, the tax commissions of the 50 States, oppose this treaty unless this reservation is adopted.

I just cannot understand why the Senate should feel compelled to approve a secret deal, negotiated by an executive branch, that Congress would be forbidden to do under the Constitution if we were to address this matter with national legislation.

Mr. JAVITS addressed the Chair.

The PRESIDING OFFICER. The Senator from New York.

Mr. JAVITS. I yield myself 5 minutes.

Mr. President, one thing I have learned in the last 10 minutes is the voice of sweet reason does not work, which is what I tried to talk with my colleague about.

Now, I do not want my colleague misrepresenting this to the Senate, because I have been reasonable. For one, what is secret about a treaty signed in 1975 and pending here since then without attention by the Senate.

Mr. STEVENS. Mr. President, will the Senator yield?

Mr. JAVITS. I yield.

Mr. STEVENS. The Senator asked me a question. I hope he will let me answer it.

Mr. JAVITS. I certainly will.

Mr. STEVENS. Not one State was contacted before this deal with the United Kingdom, not one. Our State was never contacted before this treaty was signed. It was released publicly after the deal was signed. We were told exactly the same thing as we were told on the Panama Canal Treaty; that we cannot change it because it will mean it will have to go back to the United Kingdom, for acceptance of a reservation.

I say to the Senator it was a secret deal. My State never knew about it. The executive branch negotiated away our rights without ever contacting us. Every State that looks at it has reacted the same way.

Mr. JAVITS. That is not true, because I just read two letters from two Governors who do not react the same way.

A resolution was presented to the Governors' Conference this very year to go with the Senator from Alaska and disapprove article 9(4). It was not acted on.

Mr. STEVENS. No.

Mr. JAVITS. You could not get the Governors to act on it.

One other thing I wish the Senator to answer —.

Mr. STEVENS. May I answer that first one now?

Mr. JAVITS. All right.

Mr. STEVENS. Who speaks for tax policy for the State? Is it Governor Brown or is it the California Franchise Tax Board? They are duly elected statewide officials, two of them.

Mr. JAVITS. So is the Governor. He is a duly elected statewide official.

Mr. STEVENS. The attorney general enforces the tax laws. The attorney general and the Franchise Tax Board of California. And as a matter of fact, the attorney general of the Senator's State was there at the time the Attorney General of the United States took the position opposed to this treaty.

[p. 18662] Mr. JAVITS. The attorney general of my State is not against this treaty. Is the Senator quoting him? He was there.

Mr. STEVENS. At that meeting.

Mr. JAVITS. The Senator is here now and if he loses does that mean it is wrong?

Mr. STEVENS. He was at that meeting. The attorney general is on record against this treaty.

Mr. JAVITS. So what? Suppose he was at the meeting. Does the Senator quote him?

Mr. STEVENS. Who is he? Who sets the State's tax policy?

Mr. JAVITS. The Governor.

One other thing.

Mr. STEVENS. Ask him why he did not object to this resolution in September.

Mr. JAVITS. I ask my dear friend. Is it now the law in the United States that if you do not object you approve? What kind of jurisprudence or fairness is that? What kind of childishness is that? The fact a Member does not speak here, does that embarrass him when he then votes "nay"? What kind of world are we running?

Now on another point, Mr. President.

Mr. STEVENS. How about the State legislature of the Senator's State? They were at the National Conference of State Legislators; were they not? Where were they?

Mr. JAVITS. Why does the Senator not poll the people and have a plebiscite and take a vote on that of 17½ million New Yorkers?

Mr. STEVENS. If we had had a plebiscite on other treaties, like the Panama Canal Treaty, they would never be ratified. I can tell the Senator that.

Mr. JAVITS. Both Senators of California, have started where the Senator is, have changed, with the Governor.

And one other thing: The Senator is quoting something which I have to challenge and challenge very seriously. He quoted the Congressional Budget Office.

Mr. STEVENS. I put the letter in the RECORD.

Mr. JAVITS. I know the Senator did. I am going to argue from it.

Mr. STEVENS. All right.

Mr. JAVITS. The letter said:

The Congressional Budget Office estimates that the 5-year cost of the treaty provisions other than those related to the ACT and PRT in millions of dollars will be —

Now the ACT is the payback. We are getting over $375 million back, and that is going to be taxed and it is going to be taxed

retroactively, and in addition we are getting $85 million a year which will also be taxed. The Senator did not say anything about those offsets.

Then let us read on from column 1 which says:

Fiscal year 1978 revenues loss, $100 million.

Then it takes a precipitous drop in 1979 to $28 million; in 1980 to $31 million; in 1981 to $35 million; in 1982 to $40 million; and in 1983 to $45 million. If anything it is a washout. With what is coming back under ACT and the other advantages of the treaty it has been enough to convince two-thirds of the Foreign Relations Committee and to bring onto the floor only those Senators, I wish to point out, who represent States that wish to use the unitary tax system.

Now, let me pay my respects to the fisheries and the farmlands and all the other dust that is thrown in the air. As a matter of fact, you can make any tax you please upon any corporation, U.K. corporation, which does business in your community, any tax you please, even confiscatory, unless you are stopped under the Constitution. There is nothing to prevent you from taxing their business for fishing vessels, their business for farmlands, and their property in the State. Under the treaty, the States will not be able, as some have done now under the unitary tax system, to reach out and tax them for property they have and business they do all over the world by an arbitrary proportion of whatever they do in your State, whether there is property there, business, or anything else.

That is the reason why the British and other industrialized nations properly protest against this unitary taxing system.

The United States has negotiated a treaty. It has negotiated many others affecting taxation.

Senator PELL cited one on shipping, reference to which will be found here at page 187 of the record, of the Foreign Relations Committee hearings on the treaty. Our existing Treaty of Friendship, Commerce, and Navigation with France specifically provides that French companies cannot be taxed by our States except with respect to property located in such State, income or property

derived from activities within that State, or business which the French companies do in that State.

That is, in essence, a nondiscrimination article, and we have those in every tax treaty. So there is no discrimination and you are not making a tax haven. You can tax them any way you please, but you have to tax them realistically; you have to tax them on property or business done in that particular State.

Mr. STEVENS. Mr. President, will the Senator yield?

Mr. JAVITS. I will yield in a minute.

The objection which is made by the British, and I think quite a legitimate one to the unitary other taxing system that you use is that it simply reaches out arbitrarily to operations everywhere without regard to what is done in your particular State, and that is unfair.

I yield.

Mr. STEVENS. I hope that the Senator realizes that British Petroleum is one of the owners of the right to develop our North Slope oil and BP is partially owned by the Crown. As a matter of fact, 49 percent of it is owned by the Crown.

Yesterday in answer to my colleague's first comment, the Senator from Idaho distributed to other Members of the Senate a letter which contains this statement.

With regard to its first point about the budget office, Senator CHURCH says:

The Budget Office made no estimate of the potential revenue loss to the U.S. from making creditable, dollar for dollar, against U.S. tax, Britain's Advance Corporation Tax (ACT) or the Petroleum Revenue Tax (PRT). The Revenue Effect section of the Foreign Relations Committee Report on the U.K. Treaty indicates that by making those taxes creditable, the potential loss from the ACT is "somewhere between $50 million and $100 million for the 1975-1978 period, and $15 to $25 million a year thereafter." The potential revenue loss from the PRT ranges between $300 million to $600 million per year by 1983.

Second, let me point out to my friend. I put in the RECORD yesterday the statement published by Exxon throughout the United States from November 1977 through April 1978. That statement was entitled "Let's Talk . . . About 'Equalizing' taxes." The question was asked:

Q. How does the State determine how much of a multistate company's income is taxable in Alaska?

A. Under current law, a multistate or multinational corporation's total worldwide income is apportioned to Alaska by an equally weighted three-factor formula based on the percentage of the company's total property, payroll and sales in the state. For instance, if the company has 25 percent of its total property, payroll and sales in Alaska, the company pays Alaska corporate income taxes on 25 percent of its total federal taxable income — at the corporate tax rate of 9.4 percent. Variations of this same formula are used in 42 other states and the District of Columbia in calculating income to attribute to multistate companies.

Again, let me answer my colleague's inquiry. "Where is the haven?" The haven is that now Exxon will pay that tax but BP will not even though they develop the same oil and gas in Prudhoe, Alaska. Under this treaty BP has a tax haven and it gets it for the quid pro quo of returning those stockholders' impounded funds that the Senator has mentioned.

When you really look at it, what we are doing is we are impeding my State's sovereign rights to tax equally the partners who are developing the Prudhoe gas and oil reserves. The domestic multinational corporations will continue to pay our tax. The foreign United Kingdom multinational corporations, half of it almost owned by the British Government itself, will now have a tax haven and it will have a windfall because it will not be able to be taxed on the same method.

I call the Senator's attention to the fact that resource-producing States that deal with countries such as Japan totally wash out any value of the product that they are developing in the United States. Take timber, for instance; they keep the price of the timber below actual cost as they sell it to their own corporations in Japan. They produce the pulp in Alaska and they sell it to

Japan. We can never get any income tax out of it because they sell it at a loss so what we do is we apportion, based upon their activities in Alaska, their total worldwide income based upon this three-factor formula weighted to property, payrolls, and sales to the State.

That is a very fair method, as a matter of fact, in dealing with the Japanese because they still end up by paying less than if they were a Delaware corporation. I emphasize that — less because they are selling to themselves. Under our system we have to sell at arm's length, and there is a profit factor involved. We are [p. 18663] not dealing as BP is with a Government-owned corporation. I shudder to think what is going to happen if the Senator from New York tells me that ultimately we are going to extend this same privilege to Russia. How are we ever going to deal with Russia?

Mr. JAVITS. The Senator from New York has not told the Senator that.

Mr. STEVENS. We have Russian corporations.

Mr. JAVITS. The Senator from New York has not told the Senator that. Why does he insist on assuming something and setting up a point and then arguing against it? Has the Senator from New York mentioned the Soviet Union in this debate?

Mr. STEVENS. No, I have not said that. I will yield to the Senator if I still have the time.

I say I shudder to think what would happen if the Senator told me that. He told me it is going to Canada. He has told me it is going to go to the United Kingdom. What is going to happen when it goes to a country that deals with a government-owned corporate activity in my State? The Russians do have processing ships off our shores. The Russians are entering into joint ventures with our fishermen. How are we going to tax them fairly as compared to the fishermen who come from the State of Washington?

Again, whether it is Russian or not, will the Senator tell me if this principle is going to be extended to government-owned

foreign corporations anywhere, even including the United Kingdom?

Mr. JAVITS. The Senator is a lawyer and he never answers questions which say, "Have you stopped beating your wife?" The Senator did not mention the Soviet Union and the Senator did not intend to mention Uganda or Burundi or Cambodia. The Senator can call a list of 104 nations and say I did not mention them. What does that prove?

Mr. STEVENS. Let me get to Canada.

Mr. JAVITS. I am going to just answer the Senator.

Mr. STEVENS. The Senator mentioned Canada. Tell me about PetroCan that is owned by the Canadian Government. Can it come into my State with a tax haven if we go to Canada with a similar treaty provision?

Mr. JAVITS. Let us stick to the Soviet Union which the Senator raised.

Mr. STEVENS. The Senator mentioned Canada. I want to talk about government-owned corporations.

Mr. JAVITS. We will get to Canada in a minute. The Senator mentioned the Soviet Union, and that is typical of his argument. He is assuming that the arm's-length tax method is unfair and that is why we need the unitary tax system because the Senator is unwilling to tax—.

Mr. STEVENS. Mr. President—

Mr. JAVITS. If I may just finish — you are unwilling to tax only upon business done or property owned in your State.

And now about Canada. I said, if I may just finish — and by the way we have to stop because of other Members.

Mr. STEVENS. I say to the Senator I think we should quit. I hope he will not let the record stand that I made such a concession.

Mr. JAVITS. OK.

Mr. STEVENS. I will close by saying to the Senator from New York that all of the corporations that originate in New York that come to my State will pay the tax according to the unitary method; all the corporations that come to my State from the United Kingdom will not. Let the Senator explain that to his corporations. I can explain to my State what I am doing.

Mr. JAVITS. I will explain it very well to my corporations, and the quid pro quo was more than worth it. I would like to remind you that Alaska can reach any piece of property or any business done that I wish under a system which is fully allowed to you; and as to Canada, if I may finish, that treaty will be here if it is ever made. If we do not like it, we can turn it down. That goes for treaties with Germany, France, and any other country.

I yield to the Senator from Oregon 5 minutes — I think I had better make it 3.

* * *

Mr. PACKWOOD. I thank the Senator from New York.

I join the Senator from Alaska in opposition to this whole treaty, and especially, 9(4).

This is not a new issue. Several years ago the senior Senator from Georgia (Mr. TALMADGE) introduced a bill that was referred to the Committee on Finance that would have done exactly the same thing in terms of prohibiting the unitary system of taxation that this treaty does.

At my request the Senator from Georgia did not pursue that bill because I told him if it were enacted it would cost the state of Oregon 10 percent of all of its corporate income tax revenue because that bill, of course, would have applied to all corporations, not just from the United Kingdom.

The executive branch, seeing they were not going to be able to pursue their whims through the legislative process and through the committees in both Houses, then attempted to go about it through the back door with this treaty.

I am not saying it is a secret treaty. They just know they cannot get legislation of this nature passed through both Houses of Congress.

What this is going to do, and it is not just the United Kingdom, because if it were just the United Kingdom, it would cost Oregon a very slight amount of money, but this is simply the first in a series of efforts being made by multinational corporations to have Congress extend these treaties to other countries. Example: One of the principal pulp and paper wood industry companies of this country came to me and asked me to support this treaty. I said to them, "Why on earth do you have any interest in this? You do not have any plant in the United Kingdom and I doubt that you have any forestry interests in the United Kingdom or pulp interests."

They said, "Oh, no, of course not. But when it is extended to Canada" — just like that — "when it is extended to Canada, it will mean a great deal to us," and, conversely, will mean a great loss to Oregon.

So I join with the others who object to the U.S. Government trying to tell the State of Oregon we cannot use a unitary method of taxation, one that has been tested in the courts, one that has been tested and found constitutional, one that has been tested and found fair.

Mr. SPARKMAN. Mr. President, will the Senator yield long enough for me to ask for the yeas and nays?

Mr. PACKWOOD. Yes.

Mr. SPARKMAN. Mr. President, I ask for the yeas and nays.

The PRESIDING OFFICER. Is there a sufficient second? There is a sufficient second.

The yeas and nays were ordered.

Mr. JAVITS. Mr. President, does this mean on the vote on the reservation? If not, I ask for the yeas and nays on it also.

The PRESIDING OFFICER. Is there a sufficient second? There is a sufficient second.

The yeas and nays were ordered.

Mr. PACKWOOD. I object to the State of Oregon —

The PRESIDING OFFICER. The Senator's time has expired.

Mr. PACKWOOD. May I finish in 30 seconds?

Mr. JAVITS. I yield the Senator 30 seconds.

Mr. PACKWOOD. I object to the State of Oregon being prevented from using a system of taxation that has been found constitutionally sound, fair, and equitable, that is inexpensive for the State to administer, as opposed to the apportionment method of taxation, where we will have to investigate every corporation that has some business in the State of Oregon.

In conclusion, Mr. President, I seriously object to the executive branch trying to go through the back door via a treaty for what they cannot get through legislation.

* * *

[p. 18664] The PRESIDING OFFICER. Without objection, it is so ordered.

UP RESERVATION NO. EXEC. 41

Mr. KENNEDY. Mr. President, in my statement yesterday, I gave my strong support to the reservation proposed by Senator CHURCH. I also want to associate myself with the able and effective arguments made in favor of the reservation this morning by our distinguished colleague from Alaska, Senator STEVENS. I believe that article 9(4) unfairly deprives the States of a workable and effective method of taxing multinational corporations, and I hope that the reservation will be approved.

Mr. President, in an editorial last Sunday, the Boston Globe strongly endorsed the reservation. I have placed a copy of Senators' desks, and I ask unanimous consent that it may be printed in the RECORD.

There being no objection, the editorial was ordered to be printed in the RECORD, as follows:

[From the Boston Globe, June 15, 1973]
TAXING STATE TAXATION

The advantages of lowering trade barriers and fostering international commerce have been much heralded. So too has the necessity of strengthening the ability of American states to meet the challenges within their borders. Those two objectives have come into conflict in a treaty embodying a U.S.-United Kingdom tax agreement due to come before the Senate soon.

The treaty offers much to American investors — primarily multinationals — that invest in the United Kingdom, including a $375 million tax refund for the years 1973-78 and about $85 million a year thereafter. The refunds would be derived by granting U.S. investors there tax credits to offset the double taxation of business income, as both corporate earnings and dividends, that are now granted British investors in their own country. But while American investors would benefit by the terms of the treaty, American states could suffer.

Embodied in the treaty is a prohibition against states employing a simplified method of deriving the taxes due them from British corporations operating within their borders. Instead, they would be compelled to utilize a cumbersome accounting practice that even with the promised assistance of the U.S. Treasury might be beyond their capacities. There have been wide-ranging estimates of the potential revenue losses to the states. Ultimately, the effect will depend upon whether the United Kingdom accord becomes a model for other U.S. tax treaties with other nations.

But whatever the impact — and Treasury argues that the net result could be an increase in revenues for some states — the effect of the accord would be to embody in a treaty, which neither the states themselves nor their representatives in the House had any role in drafting, a limitation on state taxing policies and prerogatives.

Foreign investors in the United States have every right to demand that they are taxed fairly by the states, that taxing formulas are not jiggered from place to place and time to time. Yet the states clearly have the right to establish their own fair procedures or, at the least, to participate fully if Washington constricts that right.

In light of these considerations, there is a strong movement afoot in the Senate to attach a reservation to the United Kingdom tax treaty voiding the section dealing with state taxing policies. It has the support of Massachusetts tax officials, as well as those in numerous other states, and it is a reasonable course.

Mr. KENNEDY. Mr. President, there remain 3 minutes under the consent agreement before we vote on the reservation. What I intend to do now is ask unanimous consent that the pending reservation may be temporarily laid aside, so that I may call up and dispose of briefly my reservation to article 23. We can probably dispose of this reservation in a few minutes, and I am confident that we can avoid the rollcall rote scheduled on it under the consent agreement.

* * *

[p. 18665] ● Mr. CHURCH. Mr. President, I requested Jerome M. Zeifman, professor of law at the University of Santa Clara, Calif., and director of the National Institute of Law and Economics, to comment on the proposed U.K. Tax Treaty and in particular on article 9(4). Professor Zeifman served as chief of staff and general counsel of the House Judiciary Committee, and as chief counsel of the Subcommittee on State Taxation of Interstate Commerce. He has also been a consultant to the State of Alaska on the taxation of multinational petroleum companies and conducted an investigation for that State of the application of the corporate income tax.

He specifically notes that article 9(4) of the U.K. Treaty "embodies a tax policy which is inconsistent with the unanimous findings and recommendations of the House Judiciary Committee." Further, he states that the support material prepared by both the Treasury and Department of Commerce "totally ignores the fact that the House Judiciary Committee recommended that a separate accounting system of taxation based on an arms-length standard be entirely prohibited for State tax purposes. This recommendation by the House Judiciary Committee was based on a unanimous finding that separate accounting was an arbitrary and unworkable method and was beyond the capacity of the States to enforce."

Professor Zeifman points out that article 9(4) should have no effect in encouraging U.K. investment in the United States because under the laws of the United Kingdom, British corporations operating enterprises in the States of the United States are permitted a full credit against the U.K. tax for income taxes paid to the States as well as income taxes to the U.S. Government.

I ask that Professor Zeifman's letter to me, an interview with Professor Zeifman in the publication TaxBACKTalk, and an analysis he prepared entitled "The Taxation by California of the Income of Multi-National Corporations," be printed in the RECORD.

The material follows:

THE UNIVERSITY OF SANTA CLARA,
June 15, 1978.

Senator FRANK CHURCH,
Committee on Foreign Relations,
U.S. Senate,
Washington, D.C.

DEAR SENATOR CHURCH: I have your letter of June 2nd, 1978 concerning the proposed United Kingdom Tax Treaty, and appreciate your concern with Article 9(4) which would prohibit our states from employing a "unitary" method to determine the taxable income of a United States enterprise controlled by a United Kingdom corporation.

As you know, during my years of service as Chief of Staff and General Counsel of the House Judiciary Committee, and as Chief Counsel of the Subcommittee on State Taxation of Interstate Commerce. I had the opportunity to investigate the corporate income tax systems of all of the states in great depth. After leaving the House Judiciary Committee in 1975 I became a Professor of Law at the University of Santa Clara, where I regularly teach a course in State and Local Taxation. In 1975 I also became a consultant to the State of Alaska on the taxation of multinational petroleum companies and conducted an investigation for that State of the application of the corporate income tax in particular. In providing you with my personal views on the

proposed treaty, I am pleased to have the opportunity to draw on these past experiences.

At the outset, let me express my dismay in observing that Article 9(4) of the proposed treaty embodies a tax policy which is inconsistent with the unanimous findings and recommendations of the House Judiciary Committee and which were set forth in that Committee's "Report of the Special Subcommittee on State Taxation of the Interstate Commerce." In that regard, it is especially noteworthy that the material supporting the treaty prepared both by Treasury and by the United States Department of Commerce, totally ignores the fact that the House Judiciary Committee recommended that a separate accounting system of taxation based on an arms-length standard be entirely prohibited for State tax purposes. This recommendation by the House Judiciary Committee was based on a unanimous finding that separate accounting was an arbitrary and unworkable method and was beyond the capacity of the States to enforce.

During the seven-year period from 1961 to 1968 when the House Judiciary Committee was actively concerned with these issues, many of the world's largest multinational corporations, which are now members of the Committee on State Taxation of the Council of State Chambers of Commerce, lobbied vigorously for federal legislation prohibiting the unitary method and requiring the states to use separate accountings. Since the Judiciary Committee totally resisted those efforts, and instead endorsed the unitary method, serious doubts now arise as to the appropriateness of the treaty device being used in a manner that places the states at the mercy of multinational corporations.

In more recent years, I have had occasion again to reexamine and reevaluate the findings and recommendations of the House Judiciary Committee. As part of my investigation on behalf of the State of Alaska in 1975, I examined the income tax liability of the thirteen largest petroleum companies operating in that State. I ascertained that during the period 1973 through 1975 seven of those companies operating in Alaska used separate accounting to determine their Alaska taxable income, and that in not one of those cases was any income assigned by those companies to Alaska for tax purposes. Instead, each separate accounting was

asserted by the multinational corporation to have demonstrated that the Alaskan operations [p. 18666] were being conducted at a loss. Under the circumstances, it seems clear to me that because of its arbitrary nature, the use of separate accounting by large multinational corporations affords those corporations the opportunity for wide-scale tax avoidance. The findings in Alaska are set forth on page 42 of the enclosed report which was prepared by me and Professor Kenneth Ainsworth for the Alaska Legislature and the Alaska Department of Revenue.

In evaluating the effects of the proposed treaty, let me urge that the Senate not only consider the fact that separate accounting is an unworkable and undesirable tax policy for the states, but that it also embodies administrative policies which have an enormous potential for political corruption. Since, in many cases, there are in fact no arms-length transactions which can be used as an administrative standard, both the tax administrator and the taxpayer are afforded the opportunity to use unbridled discretion in determining the taxpayer's ultimate liability. At the same time, since tax returns are shrouded in confidentiality, no adequate devices are available to assure that individual corporations are in fact required to pay their fair share of tax. For this reason alone I strongly urge that the Senate reject Article 9(4).

In further evaluating the material prepared by Treasury and the Department of Commerce, I believe it is also noteworthy that under the laws of the United Kingdom, British corporations operating enterprises in States of the United States are permitted a full credit against the United Kingdom's tax for income taxes paid to the States as well as income taxes paid to the United States Government. Under the circumstances, the unitary system of taxation currently employed by the states does not increase or affect the ultimate tax liability of British corporations. As a result, Article 9(4) ought properly to have no effect in encouraging British investments in the United States. That being the case, a principal argument in favor of the treaty is obviously totally without merit.

In closing, let me again thank you for the opportunity to present my views concerning these important matters. I recognize that a more detailed and more technical analysis of Article 9(4) than is

possible in this brief letter might be of further assistance. As a result, I am also enclosing an analysis which I prepared for the California Tax Reform Association as well as the Alaska study and a copy of my prepared testimony at a recent hearing of the California Assembly Committee on Revenue and Taxation.

If I can be of further assistance, please let me know.

Sincerely,
JEROME M. ZEIFMAN,
Professor of Law.

TAXING MULTINATIONALS — A CTRA FOUNDATION ANALYSIS

For some time, state and federal legislators and government officials have been considering changes in the system of taxing multinational corporations. At issue is whether or not these companies should be taxed on a percentage of their worldwide profits (the "unitary" method), or only on the profits of their subsidiaries in any given state.

On the federal level, the Senate Foreign Relations Committee last fall considered a treaty between the U.S. and the United Kingdom which would prohibit states from using the unitary method in taxing British-based multinationals, but indefinitely delayed acting on the treaty.

Governor Brown, once a supporter of the unitary method, now proposes to abolish it in California for all foreign-based conglomerates not engaged in the energy business. The Brown turnabout coincided with reports that the major impediment to Japanese corporate expansion in California is the unitary method.

In an effort to answer some basic questions about the unitary method as opposed to alternative "separate accounting" methods of taxation, TaxBackTalk recently interviewed Jerome M. Zeifman, Professor of Law at the University of Santa Clara.

Zeifman served as Chief of Staff and General Counsel to the House Judiciary Committee in 1973-74, and as general counsel to several House subcommittees in the past 15 years. In 1975 he was

consultant to the State of Alaska on taxation of multinational petroleum companies.

TaxBackTalk: Professor Zeifman, there is currently a great deal of discussion and debate regarding multi-corporate income taxation in California. What do you feel the real issues are in this debate?

Zeifman: The broad ramifications of this subject have something to do with antitrust laws. It is interesting to me that the California Franchise Tax Board is one of the few bodies in the world that looks at multinational corporations in terms of the whole picture—though one of the things that the multinational firms have been successful in doing is to divide the world's governments and conquer them.

There is no regulatory body that regulates multinational corporations as the single entities which they really are, in an economic sense. Because of the multi-corporate form of multinational corporations there has developed in the tax field widespread interjurisdictional loopholes. As a result, those of us who live almost totally within one jurisdiction end up being taxed on 100 per cent of our incomes. Whereas the multijurisdictional corporations, through these loopholes, are able to avoid paying their fair share. We pay more and more; they pay less and less.

TBT: What does the unitary apportionment approach to corporate income taxation mean in contrast to the "separate accounting" approach?

Zeifman: By applying the unitary apportionment method of corporate taxation, the Franchise Tax Board assesses the net taxable income of Mobil or Exxon or General Motors based on the percentage of the company's property, payroll or sales in California. Hence, it treats each of these companies, with its many subsidiaries, as a single business for tax purposes. Taxable income is determined by multiplying the taxpayer's entire income by a fraction which is the average of the ratios of California-to-total property, payroll and sales.

Under a system of separate accounting tax liability is determined by each taxpayer assessing its own level of profitability for each of its operating units in the state.

TBT: What do you feel the effect will be upon corporate tax receipts of abandoning the unitary approach and adopting an "arm's length" method of determining tax liability.

Zeifman: In order to conduct a proper audit based on separate accounting when you are dealing with companies the size of Mobil Oil, General Motors, Eastman Kodak or Sony, in theory, all intercorporate transactions have to be examined and be computed on an "arms length" basis. This means that if a Japanese corporation charged its subsidiary in California five million dollars for certain services, separate accounting would compel the tax administrator to determine how much the California subsidiary would pay for these services in an open market in which there was free competition.

In the world of multinational corporations there is no arms length market price available, especially on large-dollar items. The tax administration is forced to engage in the most expensive and burdensome type of audit, the so-called cost accounting analysis of all the corporation's services. I don't believe that the state is capable of conducting an adequate cost accounting of Mobil Oil and its worldwide operations.

To undo the unitary method with respect to multinational corporations would result in substantially limiting the state's power to effectively raise revenue in the corporate income tax area for multinational corporations. In my view, for California to return to a non-unitary method of taxation would be, in the state tax field, a return to the stone age of taxation

TBT: Specifically, what is the major problem with the separate accounting method?

Zeifman: The separate accounting method allows each multinational corporation to determine for itself, based on its own separate accounting, the level of profitability for each of its California subsidiaries. This is, therefore, an artificial level of profitability. In brief, it would be easily possible for a corporation

based in New York, or Japan or England, through easily arranged intercorporation transfers, to charge the California subsidiary a higher price for its services, arrange such things as intercorporate loans, so there would be a low level of income based on the separate accounts. In some cases the creation of artificial losses with respect to the California operation could be arranged.

TBT: How does the unitary approach amend that problem?

Zeifman: The unitary approach avoids what I call the "corporate shell game," which exists so long as we allow each corporation to operate under its own shell for tax purposes. The unitary approach simply corresponds to economic reality. I would argue that Mobil Oil, for example, is and ought to be viewed as a single unitary type of operation. It is really one business. Any kind of multicorporate firm, subsidairies and affiliates, which are controlled by a single parent firm or holding corporation ought to be viewed as a single economic entity for tax purposes.

TBT: If California were to abandon the unitary approach, what do you feel the effect would be upon individual taxpayers and small businesses in the state?

Zeifman: The more the state engages in tax giveaway programs, and the more the state engages in eroding its own revenue base with respect to multinational corporations the more the burdens of supporting state government are shifted to individuals who are taxed entirely. Relatively small-sized businesses which do not have the advantage of operating across state lines are in the same boat. So, in a sense, the Brown proposal to at least partially abolish the unitary method is a way of offering gigantic tax subsidies to non-California businesses and individual taxpayers.

TBT: How do you respond to the claim that the unitary approach causes double taxation?

Zeifman: When the FTB applies a unitary approach to a corporation like Mobil it is not purporting to tax Mobil's non-California income. All the FTB is saying is that it regards Mobil as a single business and in determining how much of its income is to be attributed to California for tax purposes the FTB will look at the whole picture and determine how much of Mobil's property,

payroll and sales are in California as compared to its worldwide property, payroll and sales.

There is a widely-used device in the law called "piercing the corporate veil:" looking behind corporate shells and asking who really owns the corporation. The unitary approach is simply one which says we are not going to tax corporations on the basis of mere corporate shells. We are going to look at the whole picture and look behind the corporate veil.

TBT: What do you think of the current [p. 18667] apportionment method of unitary taxation in California, and how would you change it —

Zeifman: If I have a criticism of the California unitary system, it is that it is not unitary enough because the unitary method has historically evolved, to a large extent through the courts. The legislature has never fully addressed itself to the subject.

Under the decisions of the California Supreme Court the unitary method is applied on the basis of a threefold test. The Courts look for a "unity of ownership, unity of operation and unity of management." Thus, it is possible under the judicial test for one corporation to have a wholly owned subsidiary which would not be unitary under the court's test. In this case the Franchise Tax Board would be required to make a determination as to what piece of the California subsidiary was unitary with the parent. That requires an exercise with a certain amount of administrative discretion.

I advocate taking the approach which the House Judiciary Committee took some years ago: lay down a rule that says if there is more than 50 per cent common ownership, affiliated corporations would be treated as unitary.

I would recommend to the California legislature, as I did in Alaska, that the test for unitariness be prescribed by statute simply to be one of common ownership and control.

TBT: It has been said that reverting to separate accounting opens the way for excessive administrative discretion and possible corruption. Could you comment on this observation?

Zeifman: I would be the last one to ever level the charge of corruption against the California Franchise Tax Board, and I am not saying that the undoing of the unitary tax would corrupt the FTB. However, I would regard the undoing of the unitary method as a corrupting force on tax administration in general. The use of a separate accounting method of taxation allows for an enormous amount of discretion to be exercised by both the tax administrator and the taxpayer in determining what the income subject to the tax will be.

I think it goes without saying that unbridled administrative discretion has a potential for corruption. What can make the system even more corrupt is that, in the income tax area, because of a view which is widespread in the U.S. that income tax returns are sacrosanct and shrouded with confidentiality, we now have the two cancer-producing elements in government: unbridled administrative discretion coupled with secrecy.

One thing which adversely affects the business climate is that if a tax administrator is able to exercise unbridled discretion in secret, then even though he treats me fairly, I have no way of knowing whether he has bestowed upon you any special benefits which have not been made available to me. That is not an atmosphere in which to run a railroad.

Politically in this state, I see a movement afoot to remove some of the independence of the Tax Board. Hence I would add to my observations about corruption in government a third cancer-producing element which is the politicization of law enforcement. A system based on discretion, in secret, lends itself to politicization.

Although I am sympathetic to the Governor's concern for getting companies to move to California, when a connection exists between the tax administration or any law enforcement agency and the political fortunes of the governor then the tendency would be to favor those corporations in a manner which would be most favorable to the governor's fortunes, and to correspondingly hit harder at those companies which were adverse to the governor. The separate accounting system fosters this unhealthy connection.

The Taxation by California of the Income of Multi-National Corporations

(By Jerome M. Zeifman)

Mr. Chairman and distinguished members of the Committee on Revenue and Taxation, let me first express my appreciation for giving me the opportunity to share my views on the taxation by California of the income of multi-national corporations.

More than ten years ago I appeared before this same Committee in a different capacity. At that time I was a resident of the District of Columbia and was Counsel to the Sub-committee on State Taxation of the Judiciary Committee of the United States House of Representatives. The Subcommittee, had conducted a comprehensive investigation of the taxing systems of California and of each of the other forty-nine states. I appeared here in California as a spokesman for that Subcommittee, which was then called the "Willia" Subcommittee and later became known as the "Rodino" Subcommittee.

Today I am pleased to be here in a different capacity. I recently resigned my position as Chief of Staff and General Counsel of the House Judiciary Committee and have become a Professor of Law at the University of Santa Clara. Since I now enjoy the benefits and privileges of being a new Californian I am delighted to present my views simply as a fellow resident and fellow taxpayer.

Although I have only recently become a taxpayer my associations with "the California Franchise Tax Board now go back to 1961 when the House Judiciary Committee first began our investigation of that agency. Since that time I have also participated in a wide variety of other investigations of government agencies and government officials conducted by the Judiciary Committee of the Congress. I am especially pleased to tell you today that there is no government agency, federal or state, for which I have a higher regard than for the California Franchise Tax Board.

It is because I believe that both the effectiveness and integrity of the Franchise Tax Board will be greatly impaired, if not destroyed, by the legislation before you that I would like to urge you to reject any proposal which would undo the present unitary

method of taxing foreign and multi-national corporations. Expressed conversely, let me also urge you to reject any proposal which permits any foreign corporation to use a separate accounting method of taxation under circumstances in which separate accounting is currently prohibited.

My support for the unitary concept and opposition to separate accounting falls into three inter-related areas which I would like to review for you briefly.

First, as the courts have long recognized, affiliated corporations which are commonly owned and managed, and which engage in a common enterprise, should be treated as a unitary enterprise for tax purposes. To do otherwise would do violence to economic reality and permit the inequitable distribution of tax burdens. In this regard it is especially noteworthy that not only the Supreme Court of California but the Supreme Court of the United States has for a number of years now been rejecting the use of separate accounting in favor of the unitary approach.

Second, the use of separate accounting would permit multinational corporations to engage in wide scale tax avoidance schemes which would be beyond the capacity of the state to control The inevitable results would be inestimable losses of revenue. This is because the separate accounting method would allow the foreign corporation to determine for itself, based on its own separate accounting, the level of profitability for tax purposes of its California subsidiaries.

In brief, it would be easily possible for a corporation based outside of California to charge the California subsidiary a higher price for its services and a higher price for products, and to arrange such things as intercorporate loans, all in such a way that there would be a low level of taxable income attributed to California.

With respect to the tax avoidance aspects of separate accounting, let me call to your attention, for example, the recent investigation which I conducted for the State of Alaska last year. My investigations revealed that, in the case of the thirteen largest petroleum companies operating in Alaska, whenever a tax return was filed with the state on a separate accounting basis, the

corporation reported no income whatsoever to the State for tax purposes. In this regard, let me further point out that any revenue losses to the State of California engendered by the use of separate accounting, would presumably have to be made up through the taxation of local corporations and local businesses which are located wholly within the state.

Third, under a separate accounting system of taxation, the enforcement of the franchise tax would be so severely impaired as to be in serious danger of being exposed to extreme politicization, or corruption, or both. This is because the use of separate accounting method of taxation allows for an enormous amount of discretion to be exercised by both the tax administrator and the taxpayer in determining what the income subject to tax will be. In theory, for example, all intercorporate transactions have to be examined and recomputed on a so-called "arms length" basis. Yet, in the world of multinational corporations, there is in fact often no arms length market price available which the administrator is able to use as a standard. The administrator is thus left almost entirely to the exercise of his discretion.

Mr. Chairman, and members of this Committee, I believe that each of the three reasons I have cited for opposing the use of separate accounting ought in itself to suffice as a grounds for rejecting the legislation before you, but in closing let me give special emphasis to the matter of the use of broad administrative discretion in a taxing system. I think it goes without saying the unbridled administrative discretion has a potential for corruption. At the same time, it is important to note that when we talk of the exercise of administrative discretion in the income tax area, we must also consider the fact that we are dealing with government powers that are exercised in secret, since income tax returns and income tax audits are shielded from public view. Thus, we are now dealing with two cancer-producing elements in government: unbridled administrative discretion coupled with secrecy.

Under the circumstances, since separate accounting is both a bad tax policy and embodies the worst features of bad government as taxpayer and a citizen I would like to urge you to reject the proposals before you in their entirety. ●

● Mr. DOLE, Mr. President, the pending tax treaty for the United Kingdom has generated a great deal of controversy. It has been almost a year since the Senate Foreign Relations Committee held hearings on the treaty and it has been several months since the committee reported the treaty to the full Senate.

Mr. President, our economic and social relations with the United Kingdom are close and extensive. At the present time the United States has over $14 billion in direct investment in the United Kingdom. Over $1 billion in dividends, interest, and royalties from this investment is received by U.S. investors every year.

[p. 18668] Article 9(4)

Most of the controversy about the United States-United Kingdom Tax Treaty has been generated by article 9(4) of the treaty. Article 9(4) provides that States will not tax the income of a United Kingdom corporation, determined by treaty standards, which is controlled by United Kingdom residents and is not now doing business in the United States. The treaty contemplates, however, that the States would enforce, with Federal cooperation, on arms length standards of all intercompany transactions to assure that no income properly attributable to a State could escape State tax. States that employ the unitary tax system such as California and Alaska have been strong opponents of this treaty. However, it is interesting to note that both the Senators from California and the Governors are supporting treaty ratification.

U.S. Farmland

In addition, treaty opponents state that the Treasury of the United States will lose millions of dollars in revenue. There have been charges that the treaty discriminates against individuals and will have an adverse effect on the capital and securities market in the United States. There have been some farm groups which believe that the United States-United Kingdom Tax Treaty will send the price of U.S. farmland skyrocketing.

Mr. President, I am concerned as much as any Senator in this Chamber about the effect of this treaty on U.S. farmland. However, I can find no supportable evidence that the proposed treaty would create a tax preference of foreign owned farmland and prevent States from regulating the ownership of farmland.

Administration Response

Mr. President, when the Senator from Kansas heard the charges that the treaty would have an adverse effect on our agricultural industry, I inquired at the Department of Treasury to specifically address this point. Subsequently, I believe all Senators have received a letter from Donald C. Lubick, Assistant Secretary-Designate for Tax Policy. In the case of the United States-United Kingdom Tax Treaty I am inclined to support the administration. I shall ask that a copy of the letter be inserted in the Record following my remarks.

Mr. President, the United States-United Kingdom Tax Treaty obligates the United Kingdom to make substantial refunds of taxes estimated to be near $400 million to American investors in the United Kingdom corporations. The transfer of this amount of money, from a foreign country to the United States can only be beneficial when our balance of payments is running at a severe deficit. The transfer of this money could help the value of the dollar in foreign currency markets.

Mr. President, proponents of the treaty have charged that the treaty is usurping the prerogative of the Congress to legislate. As a member of the Senate Finance Committee dealing with tax matters I find the treaty appropriate, in this instance, to settle this matter.

Mr. President, the controversy over article 9(4) has been the subject of considerable misunderstanding. From the viewpoint of the United States, article 9(4) represents a relatively minor concession in relation to the overall benefits of the treaty. The Senator for Kansas believes the treaty restriction on the so-called unitary tax system will not have a serious impact on State revenue if there is any adverse impact at all. There is a reasonable basis to believe that the other parts of the treaty, especially those requiring

repatriation of money to the United States will in fact, increase State revenues.

My decision about the United States — United Kingdom Tax Treaty has not come easy. It is my judgment that the ratification of the treaty without the Church reservation is in the best interest of the United States. This does not mean that I will automatically support the ratification of similar treaties. The Senator from Kansas believes that each subsequent treaty must be individually examined and assessed.

The letter follows:

DEPARTMENT OF THE TREASURY,
Washington, D.C., May 3, 1978.

Hon. ROBERT DOLE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR DOLE: The Senate will soon consider a proposed new income tax treaty between the United States and the United Kingdom; Secretary Blumenthal has just written you urging you to vote for the treaty and explaining its benefits to the United States. Since that letter was written it has come to our attention that two new and related arguments are being made against the proposed treaty — that the proposed treaty would create a tax preference for foreign owned farmland and prevent states from regulating the ownership of farmland. As I explain below, both arguments are unfounded.

The proposed treaty does not in any way create a tax preference for foreign ownership of U.S. farmland. The proposed treaty contains no provisions specifically addressed to the taxation of farmland. The treaty does provide in Article 6 that all U.S. real property income is taxable in the United States under normal Federal tax rules. This would include income derived from farmland. The treaty most certainly would not prevent the states from taxing farm income.

As explained in Secretary Blumenthal's letter, there are a few limited situations where pursuant to Article 9(4) of the proposed

treaty states may not use the so-called unitary method in taxing profits. At the present, there are only three states that would be affected by Article 9(4) — California. Alaska and Oregon. In the limited situations where the unitary method of taxation may not be used, the states are allowed under the treaty to use the arm's length method of controlling prices in transactions between related parties. There is a wide market for agricultural products and it is, therefor, very easy to obtain arm's length prices and to avoid any possible shifting of profits. Moreover, Federal audit information is available to state tax authorities for the purpose of determining an arm's length price.

We understand that the concern with respect to the taxation of farming profits is primarily directed at Japanese interests and not the United Kingdom. Of course, the proposed treaty with the United Kingdom does not in any way relate to Japanese investment.

Another argument with respect to the treaty's impact on farmland is that the treaty would somehow prevent the states from requiring that farmland be owned by domestic corporations or domestic persons. This argument is totally incorrect. The proposed treaty does not contain any rules affecting state laws with respect to the rights of foreign persons to own U.S. farmland or any other type of land. Although there is a non-discrimination article in the proposed treaty is this article only applies to Federal and state laws with respect to taxation. The non-discrimination article in the proposed treaty is the same in this respect as non-discrimination articles already contained in our current treaty with the United Kingdom and sixteen other U.S. tax treaties. None of those treaties require the states to alter any rules with respect to land ownership.

I hope that this letter eases any concern you might have had about the farmland question. I would be pleased if you would share the contents of this letter with those of your colleagues who are concerned about this issue.

Sincerely,

DONALD C. LUBICK,
Assistant Secretary — Designate
(Tax Policy).●

● Mr. GLENN. Mr.President, I wish to add my support for the United States-United Kingdom Tax Treaty which the Senate is presently debating.

The proposed tax treaty with the United Kingdom contains certain provisions which would be highly beneficial to U.S. based corporate and individual investors. The most significant of these provisions is the refund to U.S. investors of the U.K. advance corporation tax (ACT). The United Kingdom has eliminated double taxation by taxing corporate profits only at the corporate level. A portion of the tax collected at the corporate level is refunded to U.K. shareholders in order to satisfy the shareholder's tax liability on the dividend distribution. Under the tax treaty, U.S. shareholders would also receive this credit so as to put them on an equal footing with the U.K. shareholders. U.S. portfolio investors, those owning less than 10 percent of the U.K. corporation, would be refunded the full ACT. U.S. direct investors, those owning 10 percent or more of the U.K. corporation, would only get a 50-percent U.K. ACT refund but would receive a U.S. foreign tax credit for the nonrefunded portion.

Including U.S. shareholders within the United Kingdom integrated tax system would eliminate the inequitable situation which presently exists. The U.S. Treasury Department believes that combining the U.S. tax system with the integrated U.K. system is a significant step which could provide a precedent in the development of future tax treaties with other countries which also use the integrated tax system. Estimates are that ACT refunds, to be made retroactive, would total $375 million initially to U.S. investors in U.K. companies and amount to approximately $85 million annually thereafter.

Another significant provision in the proposed treaty would remove a disincentive which presently exists to further U.K. investments in the United States. Section 9(4) would restrict the ability of a State to use the unitary apportionment method in assessing the State income tax [p. 18669] liability of a U.K. corporation or one which is controlled by a U.K. corporation. The unitary method of taxation is a means by which several States determine corporate income for purposes of taxation by calculating the percentage of the corporation's worldwide income which

can be apportioned to the State. The controversial feature of the unitary method is the extraterritoriality of its scope. The apportionment calculation is applied not simply to the corporation which is doing business within the State, but also to affiliated corporations which may not be doing any business in the State or in the United States for that matter. This extension of State taxing power through the unitary method to foreign corporations not doing business in the State or in the United States could subject them to double taxation, and, therefore, has caused concern.

Section 9(4) would constitute only a minor limitation on State taxing power while reassuring U.K. corporations that the United States has a favorable investment climate by restricting the application of an undesirable taxing method. Moreover, concern has been expressed that if a reservation is applied to section 9(4) of the treaty it is likely that the United Kingdom will seek to renegotiate the treaty and the favorable ACT refunding provision may be substantially modified or lost.

During the Senate Foreign Relation Committee consideration of the United States-United Kingdom Tax Treaty, I opposed a reservation to section 9(4) and voted in favor of reporting the bill, as proposed, to the full Senate. I intend to maintain my support for the treaty including section 9(4) during the present Senate consideration.●

CALIFORNIA AND THE U.S.-U.K. TAX TREATY

● Mr. CRANSTON. Mr. President, the effect of the United States-United Kingdom Tax Treaty on the finances of the State of California has been widely discussed both in my State and in the Senate.

It has been urged upon me by a number of persons that I reconsider my stand in support of the treaty in the light of the passage of proposition 13.

My answer has been and continues to be to support the treaty without reservation to article 9(4).

Now more than ever California needs more revenues and the U.K. Tax Treaty is an opportunity to increase State income not by raising taxes, but by attracting more businesses to the State.

California's economy last year out-performed that of every one of the 15-leading industrial States — including all the States of the Southwest Sun Belt — by adding new jobs at a rate faster than the rate of expansion of the labor force. My State must continue that high level of economic performance if we are to meet the expectations of the more than 22 million Californians and the thousands of new daily arrivals many of whom seek to find work in California.

Few in the East are aware that California has replaced New York as the principal destination of immigrants to this country. Over 1 million aliens admitted for permanent residence live in California. Many undocumented workers live and work in our State contributing both to the strength of our economy and, unwittingly, to the potential for social conflict.

Only a highly productive and expanding company can successfully sustain the rapidly growing population of California.

On balance, I feel that ratification of the United States-United Kingdom Tax Treaty will produce substantial economic benefits for California and for the Nation.

Mr. President, it has been stated frequently on the floor of the Senate that the treaty will cost California over $125 million in lost revenues due to the limitations prescribed on the unitary tax method of assessing the corporate income tax. Some have claimed the figure "would be at least $150 million."

Mr. President, last night Governor Brown's Secretary of Business and Transportation Richard Silberman totally refuted these outsized claims of revenue loss to the State. Mr. Silberman reports that a study done for Governor Brown by the State Franchise Tax Board, under the direction of its Executive Director, Martin Huff, places the revenue loss at $10 million and not more than $15 million.

Mr. President, $10 million is a lot of money. But it is far off the mark of the $125 million and $150 million figures so casually quoted on the floor of the Senate.

In addition, the $10 million would be a barely measureable impact on the more than $1.8 billion in corporate taxes collected by the State.

The limitation imposed on California by article 9(4) simply requires that the State not apply the unitary tax method so as to tax the income of non-California related operations of the United Kingdom parent corporation.

That is an eminently fair principle of taxation and I support it.

The California Franchise Tax Board is the most efficient tax collection agency of any State. Politically, the board is more independent than the IRS. As a former Comptroller of the State of California, I have profound respect for the integrity and ability of the board and its employees. The amount of money involved in the corporate income tax collections by California substantial and well worth the effort of the board to levy and collect. I have great confidence that the franchise tax board will be as effective under article 9(4) in collecting revenues from U.K. subsidiaries as the board is today without the treaty.

The treaty deserves support and ratification. It is good policy for both California and the Nation.●

Mr. MATSUNAGA. Mr. President, both the proponents and opponents of the Church reservation have forcefully presented their views.

At first I was inclined to vote against the Church reservation, but after deeper consideration of all the implications of article 9(4), I am convinced that the Church reservation deserves the support of every Member of the legislative branch of our great Federal system.

It is true that the tax convention with the United Kingdom provides large British concessions for U.S.-owned firms who are heavily taxed in Britain. Obviously, article 9(4) banning the unitary method of taxation is a quid pro quo for the British

concessions. It has been contended that the British may not be as generous if article 9(4) is deleted. Nonetheless, I believe they will make some concession to end what is universally recognized as a discriminatory tax treatment of American companies in the United Kingdom.

Article 9(4), in my considered opinion, invokes an unwarranted intrusion on Federal and State taxing authority. The Constitution vests the power to tax in the two Houses of Congress. Also, the power of States to levy taxes is uncontestable. Only recently, the U.S. Supreme Court upheld the Iowa corporate tax apportionment formula on the ground that the Federal Constitution requires such formula be reasonable in approximating income derived from the State and does not invalidate any formula which taxes income from outside the State.

Now that the State authority has been confirmed by judicial opinion, this treaty seeks to curb that power by treaty negotiation — not by constitutional amendment and not by an act of Congress.

I cannot support such unwarranted extension of the Executive's power, and must vote for the Church reservation on article 9(4).

The PRESIDING OFFICER. Under the previous order, the hour of 11:27 having arrived, the Senate will now proceed to vote on the reservation (No. Ex-1) by the Senator from Idaho (Mr. CHURCH).

Mr. JAVITS. Mr. President, will the Senate grant unanimous consent for Alison Rosenberg of Senator PERCY'S staff to have the privilege of the floor?

The PRESIDING OFFICER. Without objection, it is so ordered.

The yeas and nays have been ordered, and the clerk will call the roll.

The assistant legislative clerk called the roll.

* * *

[p. 18670] The result was announced—yeas 34, nays 44, as follows:

Rollcall Vote No. 169 Ex.

YEAS — 34

Allen	Hatfield, Paul G.	Melcher
Cannon	Helms	Metzenbaum
Church	Hodges	Muskie
Clark	Humphrey	Packwood
Culver	Kennedy	Proxmire
DeConcini	Lavalt	Riegle
Domenici	Leahy	Sarbanes
Durkin	Magnuson	Schmitt
Garn	McClure	Scott
Gravel	McGovern	Stevens
Hart	McIntyre	Zorinsky
Hatfield, Mark O.		

NAYS — 44

Bartlett	Goldwater	Percy
Bayh	Hansen	Randolph
Biden	Hatch	Ribicoff
Bumpers	Hayakawa	Roth
Byrd, Harry P., Jr.	Heinz	Sasser
Case	Hollings	Schwelker
Chafee	Huddleston	Stafford
Chiles	Jackson	Stevenson
Cranston	Javits	Stone
Curtis	Lugar	Talmadge
Danforth	Moynihan	Thurmond
Dole	Nelson	Tower
Eagleton	Nunn	Weicker
Eastland	Pearson	Williams
Glenn	Peil	

PRESENT AND GIVING LIVE PAIR, AS PREVIOUSLY RECORDED — 4

Robert C. Byrd, for.
Sparkman, against.
Abourezk, for.

Matsunaga, for.

NOT VOTING — 18

Anderson	Ford	Long
Baker	Griffin	Mathias
Bellmon	Haskell	Morgan
Bentsen	Hathaway	Stennis
Brooke	Inouye	Wallop
Burdick	Johnston	Young

So Reservation No. Ex. — 1 was rejected.

Mr. JAVITS. Mr. President, the vote now occurs on the treaty, which requires a two-thirds affirmative vote, does it not?

The PRESIDING OFFICER. The Senator is correct.

Under the previous order, the question is on agreeing to the resolution of ratification of Executives K, Q, and J. 94th Congress, 2d session. The yeas and nays have been ordered. The clerk will call the roll.

The second assistant legislative clerk called the roll.

Mr. ROBERT C. BYRD. May we have order in the Senate?

The PRESIDING OFFICER. There will be order. The clerk will suspend until the well is cleared.

Mr. STEVENS. Mr. President, has there been an answer? I had hoped he might tell us what is going to happen after this vote.

Mr. ROBERT C. BYRD. Mr. President, no debate is allowed on a rollcall vote, but I urge Senators not to leave because we expect further rollcall votes today.

Mr. MUSKIE (after having voted in the negative). On this vote I have voted "nay." Senator BENTSEN and Senator LONG, if present and voting, would vote "aye." I, therefore, withdraw my vote.

Mr. CRANSTON. I announce that the Senator from Minnesota (Mr. ANDERSON), the Senator from North Dakota (Mr. BURDICK), the Senator from Kentucky (Mr. FORD), the Senator from Colorado (Mr. HASKELL), the Senator from Maine

(Mr. HATHAWAY), the Senator from Hawaii (Mr. INOUYE), the Senators from Louisiana (Mr. JOHNSTON and Mr. LONG), the Senator from North Carolina (Mr. MORGAN), and the Senator from Mississippi (Mr. STENNIS) are necessarily absent.

I further announce that the Senator from Texas (Mr. BENTSEN) is absent on official business.

I further announce that, if present and voting, the Senator from North Dakota (Mr. BURDICK) would vote "nay."

I further announce that, if present and voting, the Senator from North Carolina (Mr. MORGAN) would vote "yea."

Mr. STEVENS. I announce that the Senator from Tennessee (Mr. BAKER), the Senator from Oklahoma (Mr. BELLMON), the Senator from Massachusetts (Mr. BROOKE), the Senator from Michigan (Mr. GRIFFIN), the Senator from Maryland (Mr. MATHIAS), the Senator from Wyoming (Mr. WALLOP), and the Senator from North Dakota (Mr. YOUNG), are necessarily absent.

I further announce that, if present and voting, the Senator from Tennessee (Mr. BAKER), and Senator from Michigan (Mr. GRIFFIN) would each vote "yea."

The result was announced — yeas 49, nays 32, as follows:

[Rollcall Vote No. 170 Ex.]

YEAS — 49

Allen	Dole	Jackson
Bartlett	Eagleton	Javits
Bayh	Eastland	Leahy
Biden	Glenn	Lugar
Bumpers	Gravel	Matsunaga
Byrd, Harry P., Jr.	Hansen	McGovern
Case	Hatch	Moynihan
Chafee	Hayakawa	Nelson
Chiles	Heinz	Nunn
Cranston	Helms	Pearson
Curtis	Hollings	Peil
Danforth	Huddleston	Percy

Randolph
Ribicoff
Roth
Schweiker
Sparkman
Stafford
Stevenson
Stone
Talmadge
Thurmond
Tower
Weicker
Williams

NAYS — 32

Abourezk
Byrd, Robert C.
Cannon
Church
Clark
Culver
DeConcini
Domenici
Durkin
Garn
Goldwater
Hart
Hatfield, Mark O.
Hatfield, Paul G.
Hodges
Humphrey
Kennedy
Lavalt
Magnuson
McClure
McIntyre
Melcher
Metzenbaum
Packwood
Proxmire
Riegle
Sarbanes
Sasser
Schmitt
Scott
Stevens
Zorinsky

PRESENT AND GIVING A LIVE PAIR, AS PREVIOUSLY RECORDED — 1

Muskie, against.

NOT VOTING — 18

Anderson
Baker
Bellmon
Bentsen
Brooke
Burdick
Ford
Griffin
Haskell
Hathaway
Inouye
Johnston
Long
Mathias
Morgan
Stennis
Wallop
Young

THE PRESIDING OFFICER (Mr. ZORINSKY). Two-thirds of the Senators present not having concurred, the Senate does not advise and consent to the resolution of ratification.

* * *

[p. 18709] TAX CONVENTION WITH THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND — EXECUTIVE K, 94TH CONGRESS, 2D SESSION

Mr. ROBERT C. BYRD. Mr. President, I wish that both cloakrooms would indicate to Senators on our respective sides that I am prepared to move to reconsider the vote by which the United Kingdom Treaty was rejected. I being a Senator who am qualified to make that motion; and that if I do that, I also will move to reconsider the vote by which the Church reservation was rejected.

Mr. HANSEN. Mr. President, will the Senator yield?

Mr. ROBERT C. BYRD. I am trying to recall how the vote came out. I was on the prevailing side, so I would qualify. I am prepared to move to reconsider that vote.

I also am eligible to move to reconsider the vote on the Church reservation. The reason is that I am advised — if I may have the attention of the distinguished Senator from Idaho (Mr. CHURCH).

The PRESIDING OFFICER. (Mr. RIEGLE). Will the Senator suspend?

Mr. ROBERT C. BYRD. Yes.

[p. 18710] The PRESIDING OFFICER. The Senate will be in order.

Mr. ROBERT C. BYRD. Mr. President, I am advised that the administration, in view of the fact that the treaty was rejected, is willing to have the treaty with the Church reservation included. I am looking at the distinguished Senator from Idaho, and I hope I have been advised correctly. If that is the case, I will be ready shortly to move to reconsider, but I thought Senators should be put on notice.

Mr. CHURCH. Mr. President, I was just looking for the distinguished chairman of the Committee on Foreign Relations in order to convey to him a conversation I had moments ago with the Secretary of the Treasury, Mr. Blumenthal. Mr. Blumenthal told me that he thought it would be better, all things considered, if the treaty were ratified subject to the reservation.

Since this article was the only objection to the treaty, I hope it would be possible for us to agree to the reservation which strikes

article 9(4) from the treaty, and proceed then to a vote of ratification on the treaty itself. It may be that we could agree to have that vote at a time certain, the first of the week, if there is any problem at this hour on Friday, with absentee Senators. But we would want to lock in the reservation at this time; and if we proceed with that understanding, I will be amenable to it.

Mr. JAVITS. Mr. President, will be Senator yield?

Mr. ROBERT C. BYRD. I yield.

Mr. JAVITS. Mr. President, I initiated this matter with the Secretary of the Treasury because I thought he should have the decision as to whether he wanted the treaty instead of an international incident, if we rejected a United States-United Kingdom Treaty on Friday afternoon. He apparently has opted — and he told me the same thing — to have the treaty with the reservation.

I make the following suggestion: It seems to me, in the interest of comity with the United Kingdom, that if we are going to do this, we should do it all. I am advised by Senator STEVENS and Senator PACKWOOD, who also initiated this matter with me, that they are agreeable.

I believe that if the news goes out, it should go out that the treaty has been approved with a reservation, rather than leaving it hanging.

Maybe we still have enough Members here to do it on a rollcall vote, but I am informed by the Parliamentarian that a rollcall vote is not necessary. Therefore, I suggest respectfully to the majority leader and to the acting minority leader, Senator STEVENS, that we have a quorum call because Members will now have been informed that at the end of that quorum we will endeavor to consummate the whole matter unless someone wants to have a rollcall vote.

Mr. ROBERT C. BYRD. Mr. President, I must say I am very reluctant to have a voice vote on a treaty, that requires two-thirds affirmative vote under the Constitution, a treaty which has been rejected today by the Senate on a roll-call vote. I am very

reluctant now to turn around and approve that treaty on a voice vote.

I am going to vote for the treaty if the Church reservation is included, and I am willing to make the motion to reconsider. But I very much hesitate to vote a treaty here that has been a controversial treaty and to vote on it on a voice vote.

I respect the Senator from New York on his reasoning in the matter.

Mr. JAVITS. Mr. President, will the Senator yield?

Mr. ROBERT C. BYRD. I yield.

Mr. JAVITS. In the first place, I said if anyone wants a rollcall, of course. Second, may I make this inquiry? Have Members been advised that the last vote was the last one so they have a right to scatter?

Mr. STEVENS. Yes.

Mr. ROBERT C. BYRD. They have not advised to that effect on this side of the aisle.

Mr. STEVENS. Mr. President, if the Senator will yield, they have not been advised that it was for sure, but they have been advised on this side of the aisle that so far as we could determine that was the last business that would come before the Senate which would require rollcall today and we would do our best to have any rollcalls which might come up carried over until Monday. We made no assurances. I can give the majority leader that assurance. But as now when we originally started talking about this particular issue, it was on the basis that we will do everything we could here today short of a rollcall and have the rollcall on Monday, and that was conveyed to Senators who inquired on this. The word started passing that we might reconsider the treaty. I indicated it was my understanding after talking to the distinguished Senator from Idaho that we would be willing to have the rollcall vote take place on Monday. But we have not assured anyone, I say to my good friend from West Virginia. I think there has sort of been a gentlemen's interpretation here that is highly

unlikely that there would be a controversial vote take place here this afternoon.

Mr. ROBERT C. BYRD. Mr. President, in the future, may I say, in all good spirit to my friend — and he is my friend — from Alaska, that I hope — it is not my attempt to presume to control the minority side or what is being said over there — but I hope that in the future before word is given to Senators that there is not likely to be any rollcall votes on a given date that at least I be given the courtesy of an inquiry because I may know something or may have some information that would be helpful to the minority in making that judgment and we may get into a situation on a day when I would have to proceed in any event and I do not want to do anything that would embarrass the minority or embarrass any Member of the minority or the majority. But I hope that in the future — and I say this most respectfully — at least the majority leader of the Senate would at least be contacted to ask if in his judgment there is likely to be any other rollcall votes today.

Mr. STEVENS. I accept the guidance.

Mr. ROBERT C. BYRD. If I say in my judgment there will not be, then I will take the responsibility for whatever happens.

Mr. STEVENS. I accept the guidance from my distinguished friend and I will in the future tell them that my crystal ball is more cloudy than I thought it was today. I just read the crystal ball. Again we gave no assurances, but I read the circumstances as I saw them, I say to my friend, and I thought that that was proper. I accept the guidance and apologize to the majority leader if I have indicated we have gone further than we should in that regard. I really believe, though, as the Senator from New York, that we should not after having voted on this now have a rollcall vote which would not give an opportunity to those Senators who left, and we knew some left right after the vote, and not give them an opportunity now to vote for the treaty with article 9(4) deleted because many Senators took the position that they would vote for the treaty but for article 9(4) and they stood with the Senator from Idaho, as I did, and I think they now should have the opportunity to vote for the treaty with the reservation as they originally intended to do.

Mr. CHURCH. Mr. President, will the Senator yield?

Mr. SPARKMAN. Mr. President, will the majority leader yield to me briefly?

Mr. ROBERT C. BYRD. I yield.

Mr. SPARKMAN. I wish to say to the majority leader that I am perfectly willing to go along with that kind of an arrangement. I think it is very good. Let me add just a personal note. This is twice I have been caught in a jam on this very thing. In the committee I voted to report the reservation to the Senate because I felt it was something that the Senate should debate and should know about even though I was not in favor of it finally, and I find myself again in a position of endorsing something that I am not too strongly for. Nevertheless, we are seeking not only to get a peaceful settlement between the two nations, but we want to keep peace here in the Senate. I will be very glad to accede to the arrangement.

Mr. ROBERT C. BYRD. I thank the distinguished Senator from Alabama, the chairman of the committee.

Mr. President, I ask unanimous consent that the colloquy thus far be as in executive session.

The PRESIDING OFFICER. Without objection, it is so ordered.

Mr. JAVITS. Mr. President, will the Senator yield?

Mr. ROBERT C. BYRD. I yield.

Mr. JAVITS. Of course, I did not suggest a voice vote until we had a quorum and no one wanted a rollcall.

Mr. ROBERT C. BYRD. Sure.

Mr. JAVITS. If anyone wanted a rollcall, I thoroughly agree with Senator STEVENS and Senator SPARKMAN.

Mr. SPARKMAN. I wanted to say this: I have always felt that a treaty should receive a rollcall vote.

Mr. ROBERT C. BYRD. I have that feeling also.

I hesitate for the press stories to go out that only three Senators were on the floor.

[p. 18711] Mr. JAVITS. Absolutely.

Mr. ROBERT C. BYRD. That is not the case now. But that approval of the resolution of ratification of the treaty was adopted by two-thirds vote of the Senate when seven Senators were on the floor.

So I agree with the chairman. There should be a rollcall vote.

Mr. CHURCH. Mr. President, will the Senator yield for 1 minute?

Mr. ROBERT C. BYRD. I yield.

Mr. CHURCH. At the same time, it seems to me that the distinguished Senator from New York has made a very good point, that in the national interests it would be better for us to wrap this up at once so that the wrong message does not go out.

Mr. JAVITS. The Senator is exactly right.

Mr. CHURCH. And that misgivings are not created pending a final vote in the Senate next week. So I hope there is a way that we might do it today.

Mr. ROBERT C. BYRD. Very well.

Mr. MAGNUSON addressed the Chair.

Mr. ROBERT C. BYRD. Mr. President. I say to the distinguished Senator from Idaho, the distinguished Senator from New York, and the distinguished Senator from Alabama I shall ask unanimous consent in a moment to proceed in a way that will put the vote on the treaty over until Monday at a given time, and it will be late in the day. But my question is: Do you want the reservation to be adopted today by unanimous consent?

Mr. JAVITS. That I could not agree to because I wish to put both over and I wish to confine the whole proceedings to the reservation and the vote on the treaty so we have nothing else.

Mr. ROBERT C. BYRD. And back to back.

Mr. JAVITS. Right.

Mr. CHURCH. Mr. President, will the Senator yield?

Mr. ROBERT C. BYRD. I yield to the Senator from Idaho.

Mr. CHURCH. Mr. President, as to the understanding that I reached, my understanding, and I believe it was the understanding of the Senator from Alaska, was that we would settle the matter of the reservation that everyone was agreeable to accepting, so I do not see why that must be made the subject of a Senate vote. That is a basis on which we are trying to reach an agreement.

Mr. JAVITS. May I tell the Senator why?

Mr. CHURCH. I cannot agree to that. Going over until next Monday and then having a vote on it is quite a different thing than having an understanding that we are going to do it.

Mr. JAVITS. If I may just tell the Senator why, the treaty may be turned down again. Why should we have it turned down again if the reservation is in? In other words, if I may just finish, our understanding is that there will be the reservation and the treaty and that the treaty will be approved. They should be done together because other Members may get other ideas on this, that, or something else.

Mr. ROBERT C. BYRD. Mr. President, may I offer this suggestion, and I think it will get us out of this wrangle.

I would ask unanimous consent that the vote on the — Mr. President, may we have order? It is a little difficult for a Senator who has a one-track mind and who tries to concentrate on that one track to carry on a conversation with the Chair and a number of Senators in a serious way when there are so many conversations going on around the Chamber. I wonder if I might proceed in an orderly fashion with the Chair's protection.

I thank the Chair.

UNANIMOUS-CONSENT REQUEST

Mr. President, I ask unanimous consent, as in executive session, that on Monday at the hour of 6 p.m.-5:30 p.m. — I have a number of Senators who want votes late — all right, let us make it

Tuesday then — that on Tuesday at the hour of 10 a.m. a vote occur on the Church reservation to the treaty; that if the vote on the Church reservation is in the affirmative, then the Senate proceed to vote immediately on the resolution of ratification of the treaty and protocols en bloc.

In the alternative, if the vote on the Church reservation is in the negative, that no vote occur, no further vote occur, on the treaty, and that the vote stand as was given today. That protects the Senator from Idaho and it protects the Senator from New York.

Mr. JAVITS. It sounds all right to me, but no other amendment—

Mr. SPARKMAN. Mr. President, I want to ask a question there. Why separate the reservation and the treaty rather than having it as one vote, because any part of it, if it is to be turned down, I think it is a defect in the ratification of the treaty.

Mr. ROBERT C. BYRD. Well, the chairman has proposed another approach. I ask unanimous consent that at 10 o'clock on next Tuesday morning a vote occur on the Church reservation and the treaty with protocols en bloc. In that way if the Church reservation falls everything falls. If the Church reservation carries, if that vote carries, it carries everything with it.

Mr. STEVENS. Mr. President, will the Senator yield for just one moment? There is one difficulty and that is the treaty and protocols would have to carry by two-thirds whereas we only need a majority vote to carry the Church reservation, and I hope we understand what we are doing. I am not going to object. I just want to make sure everybody understands.

Mr. JAVITS. Mr. President, will the Senator yield to me?

Mr. STEVENS. Yes.

Mr. JAVITS. As a practical matter that is exactly what happened now. You really need the two-thirds either way no matter how you look at it. The treaty can always be turned down if a number of us should turn against it. We can turn it down. So I think the suggestion of the chairman protects everyone.

Mr. STEVENS. I just want the Senator from New York to understand he has to vote for the Church reservation in order to vote for the treaty.

Mr. JAVITS. I will vote for the whole treaty as well as the reservation.

Mr. ROBERT C. BYRD. Mr. President, the Senator from Alaska is preeminently correct, but the Senator from New York also has preeminently analyzed the practical situation. If we pass the treaty you have to have two-thirds. So, if you get a two-thirds vote, then the Church reservation which only required a majority vote got a two-thirds vote. But the treaty which has to have two-thirds vote has it also.

Mr. CHURCH. In other words, on Tuesday at the designated time the Senate will, in effect, vote again on the resolution of ratification of the treaty subject to the Church reservation.

Mr. STEVENS. Vote en bloc. Both items will be before the Senate at the same time.

Mr. CHURCH. Both items will be before the Senate at the same time and will stand or fall together.

Mr. ROBERT C. BYRD. May I say, Mr. President, if the Senator will allow me, that I much prefer the earlier request to this one. I much prefer to vote on the Church reservation which requires only a majority vote, and then on the basis of the outcome, vote on the treaty back-to-back. I much prefer that.

Mr. CHURCH. I prefer that.

Mr. ROBERT C. BYRD. That does not require that a reservation have a two-thirds vote, and it is just as simple as that. All the difference is that we will be having two rollcall votes back-to-back.

Mr. CHURCH. I much prefer the formulation of the majority leader, too.

Mr. SPARKMAN. May I say to the leader, Mr. President, that I have that point in mind and I was going to ask if the reservation would only require a majority vote whereas the treaty

requires a two-thirds vote, that therefore the vote probably should be separate. I will cut out the "probably."

Mr. ROBERT C. BYRD. It was on the chairman's recommendation that we are about to tie them together. I am glad he has changed his viewpoint.

Mr. SPARKMAN. I do not mean to necessarily tie the votes together but the time they would come up.

Mr. JAVITS. Mr. President, will the Senator yield to me?

Mr. ROBERT C. BYRD. Yes.

Mr. JAVITS. We are all on the same wicket and we are only trying to do what is best. Let us remember that the Church amendment was defeated by a majority and, hence, you are asking Members to change their votes on the Church reservation; whereas if you adopt the chairman's suggestion and the slight risk which is involved — it is not great because you can always turn down the treaty as you gentlemen have shown — if you adopt the chairman's suggestion you do not require Members to stultify themselves.

I will vote for the treaty with the Church reservation incorporated in it. I cannot vote for the Church reservation. I am not a fool; I opposed it. I think it is wrong. But on balance if I have got a treaty and that is the price of it I am going to pay it. So I really hope that is the route we will go. You also protect yourselves. You have got plenty of votes to turn it down. Then it [p. 18712] is a tabula rasa. That is where we are right now.

Mr. CHURCH. I would like, if I might, Mr. President, to put a question to the distinguished majority leader. Is it possible by unanimous consent simply to agree to vote on Tuesday on the ratification of the treaty subject to the Church reservation?

Mr. ROBERT C. BYRD. Yes.

Mr. MATSUNAGA. As amended.

Mr. CHURCH. So the Senate is faced with the treaty subject to the reservation, and then it either votes for it or votes against it,

even though the Senate has not independently acted by a majority vote to adopt the Church reservation.

Mr. ROBERT C. BYRD. Yes.

Mr. CHURCH. Very well. I think that is the best way to proceed. Let us understand the treaty is subject to the reservation, this by unanimous consent, and to proceed to a vote on the treaty in that form on Tuesday.

Mr. ROBERT C. BYRD. We only have one vote.

Mr. JAVITS. One vote, and no other amendments or debate will be in order; is that correct, Mr. Leader?

Mr. ROBERT C. BYRD. Right.

Mr. SPARKMAN. I would like to ask a parlimentary question, Mr. President.

Mr. ROBERT C. BYRD. I yield for that purpose.

Mr. SPARKMAN. Can the reservation be adopted by majority vote separate and apart from the treaty itself?

Mr. ROBERT C. BYRD. The answer is yes.

Mr. STEVENS. May I say to the chairman that the effect of the suggestion of the Senator from Idaho is that the unanimous-consent request is going to adopt it right now.

Mr. CHURCH. That is right.

Mr. STEVENS. That is my understanding. What we are doing is we are saying in the unanimous-consent request that the treaty is going to be before us subject to the Church reservation which deletes article 9(4) so the only vote we will have is on the treaty without article 9(4).

Mr. CHURCH. That is right.

Mr. SPARKMAN. Mr. Leader, we will have a rollcall vote?

Mr. ROBERT C. BYRD. Yes.

Mr. SPARKMAN. I think all treaties should have a rollcall vote.

* * *

UNANIMOUS-CONSENT AGREEMENT

Mr. ROBERT C. BYRD. Mr. President, I ask unanimous consent that the vote by which the Resolution of Ratification to the treaty was rejected be reconsidered, and that the vote for such reconsideration be considered as being in the affirmative; that the vote, then, on the reservation by Mr. CHURCH, by which the reservation was rejected, be reconsidered; and that a vote occur on Tuesday morning next, at the hour of 10 o'clock a.m., without further debate, motion, reservation, amendment, et cetera, on the United Kingdom Treaty with the proviso that the Church reservation is considered included therein.

The PRESIDING OFFICER. Is there objection?

Mr. CRANSTON. Mr. President, reserving the right to object, my colleague, Senator HAYAKAWA, and I have been conferring on this matter. Our State is one of those with a particular interest in the matter.

We would prefer that there be a separate vote on the Church reservation.

Mr. CHURCH. No, we cannot do that.

Mr. CRANSTON. Let me finish my remarks. We would prefer that there be a separate vote on the Church reservation, because we would like to register our opposition to the Church reservation. However, we realize that if we prevailed, that would sink the treaty.

We think, all in all, although it does not have much impact on California with the Church reservation attached to it, it is better to permit the United Kingdom Treaty to go through. Therefore, we will not object, much as we are tempted to do so.

The PRESIDING OFFICER. Without objection, it is so ordered.

● Mr. PACKWOOD. Mr. President, I voted today in favor of the Church reservation of the United States-United Kingdom Tax Treaty. This reservation would have preserved Oregon's right to apply the unitary method of accounting in determining the tax liability of British corporations doing business in Oregon. Unfortunately, the Senate defeated this reservation by a vote of 34-44.

Since the Senate failed to approve the Church reservation, I voted against the treaty. So did 32 other Senators. As a result, the Senate failed to ratify the treaty by a vote of 49-32.

This result ~~was~~ better than ratifying the treaty without the reservation.

However, several of us who participated in the debate believe that if the Senate reconsiders the vote by which the Church reservation was defeated, and if that reservation is approved, the vote by which the treaty was rejected should be reconsidered.

I believe such a vote would be favorable to treaty objectives. This would protect Oregon's and other States' right to apply the unitary method of accounting to British corporations. It would also give the British Government the opportunity to accept or reject the treaty with the Church reservation, with the hope of saving the other treaty provisions.

Apparently this is acceptable to the parties involved. As a result, the Senate will reconsider the treaty next Tuesday at 10 a.m. By unanimous consent, the form of the treaty under consideration at that time will include the Church reservation.

I appreciate the cooperation of Senators JAVITS, STEVENS, CHURCH, SPARKMAN and BYRD, and the Department of the Treasury in helping to bring about this more constructive result.●

Mr. MAGNUSON. Mr. President —

Mr. ROBERT C. BYRD. Mr. President, I still have the floor, if the Senator from Washington will allow me a moment. I am going to call up his matter in just a minute.

* * *

[p. 19076] EXECUTIVE SESSION

TAX CONVENTION WITH THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND — EXECUTIVE K, 94TH CONGRESS, 2D SESSION

The PRESIDING OFFICER. Under the previous order, the Senate will now go into executive session to vote, upon reconsideration, on the resolution of ratification of Executive K. 94th Congress, 2d session, as amended by the Church reservation.

The treaty will be stated by title.

The second assistant legislative clerk read as follows: Executive K. 94th Congress, 2d Session, Tax Convention with the United Kingdom of Great Britain and Northern Ireland, with two protocols.

The PRESIDING OFFICER. The yeas and nays have been ordered, and the clerk will call the roll.

The legislative clerk called the roll.

Mr. CRANSTON. I announce that the Senator from South Dakota (Mr. ABOUREZK), the Senator from Minnesota (Mr. ANDERSON), the Senator from Indiana (Mr. BAYH), the Senator from Mississippi (Mr. EASTLAND), the Senator from Alaska (Mr. GRAVEL), the Senator from Hawaii (Mr. INOUYE), the Senator from Louisiana (Mr. LONG), and the Senator from Mississippi (Mr. STENNIS) are necessarily absent.

I further announce that the Senator from South Dakota (Mr. MCGOVERN) is absent on official business.

I further announce that, if present and voting, the Senator from Minnesota (Mr. ANDERSON) and the Senator from Louisiana (Mr. LONG) would each vote "yea."

Mr. STEVENS. I announce that the Senator from Massachusetts (Mr. BROOKE), the Senator from Maryland (Mr. MATHIAS), and the Senator from Illinois (Mr. PERCY) are necessarily absent.

I also announce that the Senator from California (Mr. HAYAKAWA) is absent to attend the funeral of a Member of the House of Representatives.

I further announce that, if present and voting, the Senator from Illinois (Mr. PERCY) would vote "yea."

The yeas and nays resulted — yeas 82, nays 5, as follows:

[Rollcall Vote No. 178 Ex.]

YEAS — 82

Allen	Hansen	Nelson
Baker	Hart	Nunn
Bartlett	Haskell	Packwood
Bellmon	Hatch	Pearson
Bentsen	Hatfield, Mark O.	Pell
Biden	Hatfield, Paul G.	Proxmire
Bumpers	Hathaway	Randolph
Burdick	Heins	Ribicoff
Byrd, Harry F., Jr.	Helms	Riegle
Byrd, Robert C.	Hodges	Roth
Cannon	Hollings	Sarbanes
Case	Huddleston	Sasser
Chafee	Humphrey	Schmitt
Chiles	Jackson	Schweiker
Church	Javits	Sparkman
Clark	Johnston	Stafford
Cranston	Kennedy	Stevens
Culver	Lavait	Stevenson
Danforth	Leahy	Stone
DeConcini	Lugar	Talmadge
Dole	Magnuson	Thurmond
Domenici	Matsunaga	Tower
Durkin	McIntyre	Wallop
Eagleton	Meicher	Weicker
Ford	Metzenbaum	Williams
Garn	Moynihan	Young
Glenn	Muskie	Zorinsky
Griffin		

NAYS — 5

Curtis
Goldwater
McClure
Morgan
Scott

NOT VOTING — 13

Abourezk
Anderson
Bayh
Brooke
Eastland
Gravel
Hayakawa
Inouye
Long
Mathias
McGovern
Percy
Stennis

The PRESIDING OFFICER. On this vote the yeas are 82, the nays are 5. Two-thirds of the Senators present and voting having voted in the affirmative, the resolution of ratification and the Church reservation thereto, upon reconsideration, are agreed to.

Mr. ROBERT C. BYRD. Madam President, I move to reconsider the vote by which the resolution of ratification and the Church reservation thereto were agreed to.

Mr. SPARKMAN. I move to lay that motion on the table.

The motion to lay on the table was agreed to.

[p. 19077] Mr. ROBERT C. BYRD. Madam President, I ask unanimous consent that Mr. JAVITS may have 5 minutes, before going back to legislative session, to address some comments to the treaty.

Is there anyone else who wishes to speak with reference to the treaty?

The PRESIDING OFFICER. Without objection, it is so ordered.

The Senator from New York.

Mr. JAVITS. Madam President, I hope the Senate realizes that what we have done is very serious. We have for all practical purposes eliminated a very important provision of this treaty for which the United Kingdom believed it had entered into the treaty. For all intents and purposes it was for the British the critical balance contained in the treaty.

The United Kingdom considers the unitary tax system—Madam President, may we have order?

The PRESIDING OFFICER. The Senate will be in order.

Mr. JAVITS. Madam President, the United Kingdom considered article 9(4) the quid pro quo for a very large retroactive refund of about $375 million and an annual prospective refund of about $85 million to American investors. These sums, which would return to the United States are very meaningful to the U.S. Treasury. I regret, Madam President, that the British considered that the quid pro quo for providing relief to U.S. investors was this provision which would have limited application of the system of unitary taxation by a few States which the British regarded as very onerous and invidious to them.

The Senate decided that that reservation was inappropriate and defeated it. But the opponents, those who proposed the reservation, succeeded—

The PRESIDING OFFICER. Will the Senate please be in order.

Mr. JAVITS. I thank the Chair.

Those who proposed the reservation succeeded in getting enough votes, since they only needed one-third of the votes to defeat the treaty, notwithstanding that the treaty itself had a very heavy majority of the Senators voting.

Now, you really have to understand the processes of the Senate and the Constitution—and I may say that the British do—to come to understand that result. So, notwithstanding the fact that a decisive majority of the Senate is for this treaty in all its elements, it was nonetheless defeated.

It is my information that this treaty will be resubmitted to the British Parliament. What the British Parliament will do with it I do not know. But I rise this morning because our voices will be heard in the United Kingdom, and my own opinion is, and the opinion of the great majority of the Senate was, that it is an entirely fair deal that the few States which were using the unitary taxation system would be losing very little, and that the overall

national interest of the United States dictated ratification. That is the way the majority of the Senate felt and, indeed, the State of California, the largest State that would be a beneficiary of continued global application the unitary tax system, through its two Senators who voted for ratification, and its Governor who advised us that he thought on balance it was in the high economic interest of his State, supported ratification of the treaty without a reservation.

Therefore, I hope, Madam President, that the Members of Parliament will see the situation as we see it, and that they will accept the treaty, on the ground that a majority, a heavy majority, of the Senate feels as they do. I also hope that the British will negotiate another treaty or a protocol with the United States to deal with such elements of their tax situation as they consider to be fair.

Obviously, a new protocol cannot be as complete as was contained in this treaty. Nonetheless, I hope very much that just like we kept the matter open, and as I, the strongest advocate of the treaty in the Senate voted for its ratification even though this provision of the treaty removed by the reservation, that the British will ratify the treaty too. I hope that we will be able to deal with the tax situation by agreement, and that this reservation will be considered one of those incidents of our constitutional system which must be accepted, just like we accept such incidents in the British constitutional system. It is my deepest hope that the overall friendship and longstanding relationship between ourselves and the United Kingdom will dictate that this treaty should be accepted on both sides, notwithstanding my disappointment and that of the British Government with this result in the Senate.

I yield to my colleague from California.

Mr. CRANSTON. I thank the Senator for yielding. I would like to associate myself with the viewpoint expressed by the distinguished Senator from New York.

We certainly can and must explore what can now be done in the Senate by the normal process of dealing with tax laws, with a majority in favor of a change in this matter to accomplish what is

needed to meet our goals and to meet the goals of the people of England.

I would also just like to add that we have been exploring, since the original defeat late last week, with officials in California, the possibility of taking action in California in the State legislature to remedy the problem, and there is a strong possibility that that can be accomplished, and I urge the British to take that into account, too.

Mr. JAVITS. I thank my colleague. He adds a very strong dimension to what I have said. We will try in our own Federal tax law and in that of States like California to deal with this problem in a way which will at least try to cover some of the concerns raised in the deliberation on this treaty.

I thank my colleague. I yield to the Senator from Ohio.

Mr. GLENN. Madam President, I thank the Senator from New York.

I, too, would like to associate myself with his remarks. We went into this issue in considerable depth in the Committee on Foreign Relations, and I, too, hope the British Parliament sees fit to go ahead and approve this treaty with the idea that we continue negotiating on this rather vexing problem.

I have felt very strongly that the unitary tax injects States really into an international commerce situation which was never intended. But, as I understand it, this has been tested in the courts and found to be constitutional. I would hope the British would take the view that some of us here are taking and that is that the treaty is worth approving as is, and will continue negotiating on this other problem which I feel, and I am sure the Senator from New York feels, from our previous conversation, is particularly unfair.

I thank the Senator.

Mr. JAVITS. I thank my colleague very much. He was very helpful.

I yield to my colleague who managed the bill, the Senator from Rhode Island (Mr. PELL).

The PRESIDING OFFICER. The Senator's 5 minutes have expired.

Mr. JAVITS. Madam President, I ask unanimous consent for 2 additional minutes.

The PRESIDING OFFICER. Without objection, it is so ordered.

Mr. PELL. Madam President, I would like to second the views advanced by the Senator from New York. This was a good treaty. It was approved by the majority of the Senate. It is still a better treaty than none the way we passed it, and I would hope the British Parliament would see fit to ratify it.

I recognize that what we have done with our reservation is to remove some of the attractiveness of this treaty from the United Kingdom's viewpoint. So our negotiators, when they get back together, are going to have to figure out a little bit whether the pot will have to be sweetened and what will be necessary to sweeten the pot.

But I would think this treaty should move along, and I would hope that the Members of Parliament, when they do consider it, will bear in mind the remarks on the Senate floor, and will bear in mind the fact that the majority of our colleagues supported it, will bear in mind that it is to the mutual advantage of both our nations to move down this road and ratify the treaty along these lines.

Mr. SPARKMAN. Madam President, I am glad we have had this very successful vote in behalf of this treaty. While I opposed the Church reservation, I did state at the time that we could live under it, and that the treaty was of such importance, this treaty between the two countries, that by all means I felt that we should accept the reservation and [p. 19078] ratify this treaty. I am gratified that the vote was so successful.

Mr. JAVITS. Madam President, I ask unanimous consent that a statement by Senator PERCY be placed in the RECORD in connection with the treaty.

The PRESIDING OFFICER. Without objection, it is so ordered.

STATEMENT BY SENATOR PERCY

I deeply regret the action taken last week by the Senate on the United States-United Kingdom Tax Treaty. Although the reservation which effectively cancels article 9(4) of the treaty was defeated, there were not the required votes of ⅔ of the Senators present and voting to approve ratification of the treaty.

As I stated during last week's debate, I believed that the treaty was beneficial to the United States, that it encouraged the free flow of trade and investment, and that it was an important contribution to our Government's policy of promoting international economic cooperation.

I felt it was more than adequately demonstrated during the debate that article 9(4) of the treaty did not represent a blanket prohibition on a State's use of the unitary apportionment method of taxation, but only restricted its use when applied to the operations of a United Kingdom corporation not doing business in a State. It seemed to me this use of the unitary method was unreasonable and unfair. Furthermore, it has been a disincentive for investment in the United States, as the Senators and Governor from California can attest. Finally, I believe it was clearly shown that article 9(4) would not in any way have created a tax preference for foreign ownership of U.S. farmland.

However, the Senate has worked its will, and it is now incumbent upon us to approve the treaty as amended by the reservation to article 9(4), in the hope that at least some of the treaty can be salvaged. We cannot predict what conditions the United Kingdom will now seek to compensate for the loss of the benefits under article 9(4). But at least we will not be giving what could have been interpreted by our friends and allies in the United Kingdom as a slap in the face if we had just let the treaty die. At least this will provide an opportunity for further discussions by both governments. This is my view and I know it is shared by many interested parties in Illinois. Therefore, I urge support for the amended treaty.

Mr. MORGAN. Mr. President, this morning, I voted against the proposed United States-United Kingdom Tax Treaty which included the Church reservation. My reasons for doing so were a

concern over method, the lack of equitability, the potential for increased costs to the American taxpayer, a further delay in obtaining tax advantages, and the possibly negative impact on current tax negotiations with France, Germany, and Canada.

Last Friday, we rejected the Church reservation by a comfortable majority only to find it reappear in today's version of the vote. Thus we combined two issues, one which requires only a majority vote, namely the Church reservation, and ratification of the treaty and its two protocols which require a two-thirds vote. I would have very much preferred to follow the original suggestion of the Senator from West Virginia, made last Friday, to have two votes back to back, thereby keeping votes and issues apart. I am convinced that in this case we would have had a treaty today including article 9(4).

As you will recall, Mr. President, article 9(4) places some restrictions on the application of the unitary tax method to British corporations operating in this country. It would have constituted only a minor concession as attested to by the Governor of my State, and the Governors of many other States. In return, the British Government would have been prepared to grant the United States a tax refund of approximately $375 million and a future annual tax saving of $85 million.

It was a concession for a concession. With the deletion of article 9(4), we are jeopardizing this additional income to the possible disadvantage of the American taxpayer.

With the Church reservation now included in the treaty, a treaty which had already been passed by the British Parliament, the document will now have to be renegotiated. This will not only mean a costly delay, but in the process, we may very well lose some of the tax benefits that had been stipulated earlier. There is also every reason to believe that our tax treaties with other West European countries and Canada may be affected if we are not willing to offer a quid pro quid.

By voting for the Church reservation together with the treaty, my colleagues have placed themselves at the mercy of the British Parliament not to reconsider their own tax concessions to us. We are thus relying on their good will which we were not willing to

show ourselves. This issue is far from closed and I have no doubt that this body will again be asked to deliberate a new tax treaty with the United Kingdom, one which will unfortunately be less favorable than the version which was before us earlier.●

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